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Current economic instability: Accounting and auditing considerations - 2009; Audit risk alerts

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Current Economic Instability: Accounting and Auditing Considerations — 2009

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2009

Current Economic Instability:

Accounting and Auditing Considerations

STRENGTHENING AUDIT INTEGRITY
SAFEGUARDING FINANCIAL REPORTING

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AUDIT RISK ALERT

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Notice to Readers

This Audit Risk Alert is intended to provide auditors of financial statements with an overview of recent economic, industry, technical, regulatory, and professional developments that may affect the audits and other engagements they perform. This Audit Risk Alert also can be used by an entity's internal management to address areas of audit concern.

This publication is an *other auditing publication*, as defined in AU section 150, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1). Other auditing publications have no authoritative status; however, they may help the auditor understand and apply the Statements on Auditing Standards.

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Keira A. Lichtenstein, CPA
Technical Manager
Accounting and Auditing Publications

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How This Alert Helps You

.01 The difficult economic climate continues to make accounting for transactions and auditing entities more challenging than ever. This Audit Risk Alert (alert) helps you plan and perform your audits in the current economic environment. This alert also can be used by an entity's internal management to address areas of audit concern and is an important tool in helping you identify the significant risks that may result in the material misstatement of financial statements given the current economic conditions. In today's environment, which continues to affect all types of businesses and industries, it is crucial to remain alert to current events and evaluate how they affect the audits you perform. This alert delivers information about emerging practice issues and current accounting, auditing, and regulatory developments. You should refer to the full text of accounting and auditing pronouncements as well as the full text of any rules or publications that are discussed in this alert.

.02 Certain accounting guidance referenced in this alert has been codified into the Financial Accounting Standards Board (FASB) *Accounting Standards Codification*™ (ASC). On June 30, 2009, FASB issued FASB Statement No. 168, *The* FASB Accounting Standards Codification™ *and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162*. On the effective date of this statement, FASB ASC will become the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance issued by the Securities and Exchange Commission (SEC). At that time, FASB ASC will supersede all then-existing, non-SEC accounting and reporting standards for nongovernmental entities. Once effective, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC will become nonauthoritative. See the discussion of FASB ASC in the "Accounting Issues and Developments" section of this alert.

Economic, Legislative, and Regulatory Developments

The State of the Economy

.03 The current recession, which officially began in December 2007, is the longest recession since the end of World War II. At this point, what is not certain is when the recession will end and when things will return to "normal." Further, there is no clear idea of what the new normal will be; what is known is that the United States cannot repeat the same actions that led to this economic crisis.

.04 For the past few years, U.S. consumers have been living above their means and spending more than they earn. This lifestyle and the economic growth it spurred—because household spending accounts for 70 percent of the economy—were unsustainable. Consumers' personal savings rate was negative 0.5 percent in 2005, the first time a negative savings rate occurred for an entire year since the Great Depression of 1932–1933, when the personal savings rates were negative 0.9 percent and negative 1.5 percent, respectively. Back then, Americans dipped into savings to cover basic living expenses. In 2005, the booming housing market created what some economists called a "wealth effect." Americans felt confident enough to spend all of their disposable income and dip into their savings because housing prices were rising at impressive rates. By May 2009, the savings rate in the United States rose to its highest point in more than 15 years, at 6.2 percent. By June 2009, however, it had declined to 4.6 percent. The high savings rate is in response to a rising unemployment rate (9.4 percent in July 2009) and the $1.33 trillion, or 2.6 percent, loss Americans experienced in their net worth in the first quarter of 2009 from the fourth quarter of 2008.

.05 The loss of net worth is slowing. However, in the fourth quarter of 2008, Americans' net worth dropped 8.6 percent—that was more than three times as high as the decline in the first quarter of 2009. This exhibits why many economists, including Federal Reserve Chairman Ben Bernanke, are saying the recession will probably end in 2009. Although many economic statistics are still in negative territory, the degree to which they are negative is improving.

.06 The IHS Global Insight Economic Index predicts future gross domestic product growth based upon 11 forward-looking indicators, including nondefense capital goods orders, stock prices, institute for supply management export orders, the real federal funds rate, the interest rate yield curve, light vehicle sales, the corporate bond spread, building permits, hours worked, average growth rate of real money supply, and crude oil prices. Of the 11 indicators in the May 2009 report, 7 were positive, which led IHS to predict the recession would end by September 2009. More convincing were the following 3 positive signs—the interest rate yield curve is steepening, big ticket item orders are up, and the stock market rose strongly from April to May. However, the study was cautious in noting that the speed of the recovery will likely be slow.

.07 According to the AICPA and University of North Carolina Kenan-Flagler Business School's Business & Industry Economic Outlook Survey Q2 2009, for the first time in 2 years, the proportion of respondents expressing optimism about the U.S. economy has increased quarter to quarter, from 5 percent to almost 20 percent. Additionally, the CPA financial executive respondents communicated the top challenges facing their own organizations. In both the first and second quarters of 2009, customer demand remained the top challenge and employee health care costs remained the third top challenge. However, the second top challenge changed from collection of receivables to access and cost of capital. The surveyors believe this is not indicative of credit tightening, but rather collection of receivables and employee health care costs improving. Although the survey results do not demonstrate a complete turnaround, they do exhibit an increasing general optimism about where the economy may be headed over the next 12 months.

The American Recovery and Reinvestment Act of 2009

.08 In February 2009, President Obama signed legislation designed to work hand in hand with the Emergency Economic Stabilization Act of 2008 (EESA) to stimulate the U.S. economy. The American Recovery and Reinvestment Act of 2009 (Recovery Act) is designed primarily to combat the rising unemployment trends, put more money in the hands of consumers, and reduce the likelihood that state and local governments will need to raise taxes significantly. According to the White House press release, the legislation will do the following:

- Create or save 3.5 million jobs in the next 2 years
- Provide direct tax relief to working and middle class families
- Double the U.S. renewable energy generating capacity over 3 years
- Stimulate private investment in renewable energy through tax credits and loan guarantees

- Invest $150 billion in U.S. infrastructure projects
- Provide funds to U.S. state and local governments to support health and education programs

.09 Many of the provisions of this legislation took effect immediately in an effort to stimulate consumer spending and boost the economy. The total cost of the spending in the Recovery Act is $787 billion, which is in addition to the $700 billion in the EESA. A large portion of the Recovery Act funding will go to states as prime recipients, which will then distribute funds through grants, contracts, subsidies, loan programs, and additional programs to other entities (subrecipients). Generally, only the prime recipients will be subject to the submission rules of formal reporting of monies received and used under the Recovery Act. These prime recipients may, however, request assistance and certain information from the subrecipients to compile these reports. Any entity receiving funding from the Recovery Act, directly or indirectly, should consider the effects on the accounting and auditing functions, especially if the funding is in large amounts not typically received by the entity. The effects may include the need to

- strengthen internal controls;
- engage auditors to specifically assess the internal control environment;
- consider the impact on the entity's liquidity if there is a requirement to repay any Recovery Act funds;
- consider any tax implications of receiving the funding;
- determine how the receipt of funding will be disclosed in financial statements; and
- create performance metrics to measure the progress and success of investment of the Recovery Act funds.

.10 Many economists are concerned that further financial support may be necessary before an economic recovery is possible. Additionally, the federal government developed the Web site www.recovery.gov to facilitate a transparent process to ensure accountability for the execution of the package.

Proposed Financial Regulation Rules

.11 In June 2009, the administration revealed proposed rules that would significantly shape the new marketplace. The proposed rules would change the level of oversight the U.S. government has on financial markets and give the Federal Reserve more methods to oversee the economy. The proposed rules are intended to prevent the current economic crisis from happening again. At the time of this writing, the proposed rules have yet to be fully addressed by Congress. The administration established 5 key objectives in their new proposal, including

- require strong supervision and regulation of all financial firms,
- provide the government with tools to effectively manage financial crises,
- strengthen consumer protection,
- strengthen regulation of core markets and market infrastructure, and
- improve international regulatory standards and cooperation.

Require Strong Supervision and Regulation of All Financial Firms

.12 This first objective would be achieved by a new national bank supervisor and a financial services oversight council of regulators as well as the elimination of the federal thrift charter and loopholes in the Bank Holding Company Act. A new level of power also would be given to the Federal Reserve to supervise and regulate any financial firm that is "found to pose a threat to our economy's financial stability based on their size, leverage, and interconnectedness to the financial system." Critics worry whether the Federal Reserve has the toughness and expertise to oversee commercial banks, investment banks, big hedge funds, private equity funds, and other financial institutions. Additionally, advisers to hedge funds and other private pools of capital (including private equity funds and venture capital funds) will be required to register with the SEC once their assets under management exceed a modest threshold. Lastly, accounting standards would be reviewed to determine how financial firms should be required to employ more forward-looking loan loss provisioning practices. Fair value accounting standards would be reviewed to identify changes that could provide market participants with fair value information and greater transparency regarding expected cash flows of investments.

Provide the Government With Tools to Effectively Manage Financial Crises

.13 The second objective would be achieved primarily by preventative actions. This includes imposing more stringent capital, activities, and liquidity requirements on large, interconnected firms, requiring large financial firms to prepare and continuously update a credible plan for the rapid resolution of the firm in the event of severe financial distress, and providing the government with emergency authority to resolve any large, interconnected firm in an orderly manner. To invoke this authority, the Treasury Department would need to determine whether the firm is in default or in danger of defaulting, whether the failure of the firm would have serious adverse effects on the financial system, and whether the use of the special resolution authority would avoid or mitigate these adverse effects.

Strengthen Consumer Protection

.14 The third objective would be achieved by the creation of a new Consumer Financial Protection Agency. This agency would have broad authority to protect consumers of credit, savings, payment, and other consumer financial products and services, and to regulate all providers of such products and services. For example, this agency would have the authority to reform mortgage laws. This agency would aim to improve and simplify disclosures so consumers have a clear understanding of the benefits and costs associated to the transaction. It also would define standards for "plain vanilla" products that are simple and have straightforward pricing. Although this would create a safer financial marketplace for consumers, critics claim the simplified products would make it difficult for financial firms to distinguish themselves and would stifle innovation for financial products. On the other hand, many see the underlying cause of our economic crisis to be a system that allowed consumers to enter into loans for which they should not have qualified or that had terms they did not understand.

Strengthen Regulation of Core Markets and Market Infrastructure

.15 The fourth objective would be primarily achieved through comprehensive regulation of the derivatives market, tightening regulation on credit rating agencies, and changing securitization laws. All credit default swap and other over the counter (OTC) derivative markets would be subject to regulation for the first time. They also would be required to be centrally cleared and executed on exchanges and other transparent trading venues. Customized OTC derivatives would also require higher capital charges. By implementing these regulations, the derivative markets would become much less profitable. Further, many derivatives are customized and complicated, which suggests that their regulation may not be possible, which would undermine the goals of the regulation. The SEC will continue to tighten regulation on credit rating agencies to ensure firms have robust policies and procedures to manage and disclose conflicts of interest. Regulators also will aim to reduce their use of credit ratings in regulations and supervisory practices. In regard to securitization, the originator or sponsor of a securitization would need to retain five percent of the credit risk of securitized exposures. This securitization rule is aimed to align the motives of loan originators with the end investor of a mortgage security; both parties would now have a stake in ensuring that the borrowers will not default on their loans.

Improve International Regulatory Standards and Cooperation

.16 Lastly, the fifth objective would be accomplished by numerous actions. These include strengthening the international capital framework, subjecting foreign financial firms operating in the United States to the same standards as U.S. firms, improving oversight of global financial markets, and enhancing supervision of internationally active financial firms.

Debate Surrounding Proposed Regulation

.17 The overall sentiment about the administration's plan is that it is ambitious and that reform is definitely needed; however, many special interest groups have strong opposing views about varying aspects of this plan. Further, the question as to how these reforms may diminish profits and growth of the financial sector has been raised. The four most debated aspects of the plan include the consumer protection agency, the five percent stake in securitizations, the dramatically increased power of the Federal Reserve, and the regulation of the derivative markets.

Repayment of Troubled Asset Relief Funds

.18 In June 2009, the Treasury Department cleared 10 of the nation's largest banks so they could repay $68 billion received from the Troubled Asset Relief Program (TARP) in late 2008 by redeeming preferred shares the government acquired in them last fall. But first, as outlined in EESA, the banks had to pass a stress test in order to repay the funding. Some analysts have said one factor that helped banks pass was the changes in fair value accounting by FASB in early 2009; others maintain the original rules were flawed and now the banks' balance sheets are more realistic. Passing these stress tests also may truly indicate the improvement in the banks' financial health.

.19 The repayments by these 10 banks represent the first major repayment of TARP funds. Up until this point, mostly only community based lenders had redeemed the government's preferred shares in the aggregate amount of $1.9 billion. These banks also have the ability to repurchase the warrants acquired in them by the government at fair market value, which 7 have already done. Each bank is required to have an independent advisor determine this value, and the Treasury Department must accept this value before the bank may repurchase the warrants. If the bank and the Treasury cannot resolve any differences in the fair values of the warrants, each selects an appraiser to value them and come to a mutual agreeable value. If 2 appraisers cannot come to an agreement, they agree on a third appraiser to value the warrants. The 3 values are then averaged, not including outliers, to determine fair market value. The bank also has the option of not repurchasing the warrants. In these instances, the Treasury Department will sell the warrants through an auction process to help determine their fair value. The Treasury Department noted that it has no intention to hold onto the warrants until their expiration. At the time of this writing, one major bank has bought back the warrants held by the Treasury Department, and assigning values to these warrants was a source of contention.

.20 The final prices these warrants are sold for, whether to the original bank or through an auction, are important; if the Treasury Department sells them at too low a price, accusations may be made that banks have been favored over taxpayers. However, as evidenced during the economic crisis, determining fair value for illiquid investments is extremely challenging and complicated.

.21 A common valuation method for warrants is options models, such as the Black-Scholes model. This model has 6 inputs, including stock price, strike price, risk free interest rate, dividend yield, time to maturity, and implied volatility. The warrants issued to the government have a 10-year maturity, and based on the assumptions used in these inputs, the output fair values can vastly differ.

.22 Inclusive of the 10 banks' dividend payments and the warrant repurchases, the White House said that the government would make a profit on its investment in these banks. The Treasury has stated the returns also should be considered from a nonfinancial standpoint; specifically, financial stability provided by TARP funding. The government said it earned an annualized return of 23 percent on 1 major bank that has completely repaid all funds to the Treasury. However, the government took a loss on 11 smaller banks that had repurchased their warrants. In July, the Congressional Oversight Panel reported that these warrants were worth $28.2 million but had been repurchased for only $18.7 million. However, it also was noted that these warrant sales represent less than 1 percent of the warrants held by the government.

.23 The motivation for these banks to repay this funding is to avoid the restrictions government places on them, including compensation restrictions, limits on the hiring of foreign workers, dividend increases, and restrictions on company perks (such as conferences and corporate jets). A positive sentiment and return of confidence occurred with the repurchasing banks because repayments give the impression these banks are healthier than ever and ready to rebound from the recent economic crisis. Additionally, some analysts have said the restrictions placed upon these banks put them at a disadvantage with hedge funds luring away employees and other banks that have repaid the capital. Lastly, analysts have expressed concern over the wary investor sentiment of partnerships with the government.

.24 However, a main concern about these repayments is whether they were best for the overall economy and bank shareholders or best only for the banks. Fear that these banks may decrease lending to compensate for the large cash outflow could hurt their bottom line as lending is a source of income and of the overall economy. Additionally, if banks must pay higher interest rates to investors as they are now without government backing, this will hurt their bottom line.

Public-Private Investment Program

.25 In early July 2009, the Treasury Department announced the long anticipated details of the Public-Private Investment Program (PPIP), frequently referred to as the toxic asset program. The Treasury Department will invest up to $30 billion in partnerships with fund managers to buy toxic assets from banks and other qualified firms. PPIP will start by targeting commercial mortgage-backed securities (CMBS) and nonagency mortgage-backed securities issued before 2009 with an initial rating of AAA or its equivalent. The selected fund managers to participate in PPIP include 9 major money manager firms and 10 smaller, minority- and woman-owned firms. For the fund, the managers must put in $20 million of their own cash and raise at least $500 million over the next 12 weeks. At that point, PPIP will commence. Firms that meet the requirement will be able to take advantage of both equity and debt financing from the Treasury Department. The Treasury Department is prepared to match up to $10 billion in capital raised by the funds, with an additional $20 billion in debt financing. The Treasury Department also has stated that if market conditions were to deteriorate, it could expand its investment in PPIP. The fund managers may raise money from any investor, including sovereign wealth funds and other foreign investors. No single investor will be able to own more than a 9.9 percent ownership interest in any one PPIP fund. The fund managers must operate the partnership for at least 8 years and provide monthly information to the Treasury Department.

.26 PPIP was originally announced in conjunction with TARP of 2008 because these toxic assets have been a strong driver behind the economic crisis. Today's version has been reduced mainly because of the recovery steps already taken by many banks. Banks also are reluctant to sell their assets for too low a price and investors have become somewhat wary of partnering with the government. Further, the initial program also was going to include the Federal Deposit Insurance Corporation, purchasing up to $500 billion in real estate related loans from banks. This has been postponed indefinitely due to lack of interest from buyers and sellers.

.27 Although PPIP will not eliminate all of these toxic assets from banks' balance sheets, the goal is for some of these assets to be sold, freeing up capital banks can then use towards meeting the goal of resuming normal lending activity. One of the difficulties of PPIP is the opposing interests—banks are reluctant to sell to investors at fire sale prices and record losses—yet members of Congress have expressed concern about overpaying for assets that may never recover. However, another motivating factor for some banks may be to raise capital or increase capital ratios. Another goal of PPIP is to create an initial market for these assets and establish prices that others can use for reference. It remains to be seen how successful PPIP will be in improving the securities market for these toxic assets and freeing up capital for banks to increase lending.

Term Asset-Backed Securities Loan Facility

.28 Late in 2008, the Federal Reserve announced the creation of the Term Asset-Backed Securities Loan Facility (TALF). The Federal Reserve Bank of New York will lend up to $200 billion to holders of certain AAA rated asset-backed securities (ABS) backed by newly and recently originated consumer and small business loans through December 31, 2009. The intent of this facility is to increase credit availability for student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Administration.

.29 In March 2009, the Federal Reserve Board expanded the eligible collateral for loans extended by TALF to include ABS backed by mortgage servicing advances, loans or leases related to business equipment, leases of vehicle fleets, and floorplan loans. In May 2009, the maturities for TALF loans were extended to 5 years (from 3) and eligible collateral under TALF was expanded to include CMBS and securities backed by insurance premium finance loans. Certain CMBS issued prior to January 1, 2009 (legacy CMBS), in addition to newly and recently issued CMBS, are eligible collateral under TALF.

.30 During the height of the economic crisis, CMBS issuance came to a screeching halt, which drove the economy down even further. This prompted numerous industry groups to lobby for their inclusion under TALF. The inclusion of newly and recently issued CMBS ideally will stimulate commercial lending, which has the power to prevent defaults on current commercial property loans, increase the capacity of current holders of maturing mortgages to make additional loans, and facilitate the sales of distressed properties. The inclusion of certain legacy CMBS also is intended to promote price discovery and liquidity for legacy CMBS. The goal of the improvements to the legacy CMBS markets is to promote new issuances of CMBS, which helps borrowers purchase commercial properties or help a current owner of a commercial property refinance on better terms. Overall, the commercial real estate market still needs to be stabilized and have a drop in interest rates, which, it is hoped, can be achieved by the recent changes to TALF. According to JPMorgan Chase & Co. estimates, there were $237 billion in CMBS sales in 2007 and $12.2 billion in 2008.

.31 The first deadline for investors to apply for loans to buy new CMBS through TALF was June 16, 2009, and there were no applicants. This is consistent with the results of the July and August 2009 investor requests. The 2 most cited reasons for this are that the securitization process takes a while to ramp up and there is a slow discovery process by investors and originators. This is consistent with the first launch of TALF in March 2009; the first 2 months had under $5 billion in requests, yet the next 2 months had requests that exceeded $10 billion. Also, a typical CMBS deal can take up to 6 months from when a loan is originated to when it is securitized. By late July, the first entity to launch 2 bond sales with the hopes of raising $600 million through TALF was announced.

.32 July 2009 marked the first deadline for requests for loans to buy legacy CMBS through TALF and investors requested a total of $668 million in loans. In August, the request rose to $2.3 billion. The market declared this an important beginning to the program. However, critics noted that the restricted specifications of the program may hinder the program's overall success in helping the commercial real estate sector. For example, the stable AAA rating requirement eliminates a large percentage of CMBS, especially when many are currently at risk of being downgraded (and therefore not stable). Recently, Standard & Poor's, one of the 4 major rating agencies, adopted more conservative rating models, which prompted 1,500 ratings to be added to the list of potential downgrades. Additionally, unknown criteria, such as acceptable delinquency rates, increase investors' uncertainty over eligibility of bonds they hold. In August, the program was extended beyond December 2009 to June 2010. The remainder of 2009 will show the extent to which investors and originators take advantage of the TALF for CMBS and whether that can help revitalize the CMBS market.

Short Selling

.33 In April 2009, the SEC released a proposal for public comment on 5 alternate approaches to restricting short selling. *Short selling* is selling securities not owned by you and attempting to purchase replacements at a lower price and making a profit on the difference in the price you agree to sell it for versus the price at which you expect to buy it. This is a profitable strategy when the stock price is declining. SEC Chairman Mary Schapiro noted the following in her April 8, 2009, speech:

> The Commission has long held the view that short selling provides the market with important benefits, including market liquidity and pricing efficiency. But, short selling may also be used to illegally manipulate stock prices. One example is the "bear raid" where an equity security is sold short in an effort to drive down the price of the security by creating an imbalance of sell-side interest. In addition, unrestricted short selling can exacerbate a declining market in a security by increasing pressure from the sell-side, eliminating bids, and causing a further reduction in the price of a security by creating an appearance that the security price is falling for fundamental reasons, when the decline, or the speed of the decline, is in fact being driven by other factors.

.34 This is not the first time restrictions on short selling have been considered or implemented. The SEC piloted short selling restrictions and studied the effects from May 2005 to August 2007. The current relevance of those studies has been called into question, however, as the economic crisis has dramatically changed the markets since then. Additionally, in July 2007, the uptick rule contained in Rule 10a-1 of the amended Securities Exchange Act of 1934, which prevented bear raids, was eliminated. The uptick rule prohibited any short sale unless that price was higher than the prior sale price. This essentially permitted short selling only if there had been an increase (or uptick) in a stock's price. As the economic crisis was deepening in the second half of 2008, the SEC issued numerous temporary emergency orders on short selling restrictions. It is difficult to determine, however, how much these emergency orders helped the markets and if the timing of these releases were ideal. Some believe bear raids contributed to the steep drops in stock price of many financial institutions and, in some cases, the demise of these institutions. The SEC also noted that some investors said they feel less confident in investing in the markets without additional restrictions on short selling.

.35 The 5 alternatives in the proposed release on short selling fall into 2 categories, including the marketwide permanent approach and the security specific temporary approach. The marketwide permanent approach has 2 proposed alternative rules. The first is the uptick rule and the second is a modified version of the uptick rule that changes the price comparison from the last sale price to the current best national bid. The security specific temporary approach has 3 alternative proposed rules. The first is the *circuit breaker halt rule*, which prohibits short sales on an individual security (absent an exception) for the remainder of the trading day if its price has declined by at least 10 percent from the prior day's closing price. The second 2 alternatives are the same as the marketwide permanent approach proposed rules, except that the restrictions under each would be triggered only if an individual security's price has declined by at least 10 percent from the prior day's closing price. Comments to the SEC were due in mid-June. Readers should be alert for a final release on short selling in the coming months.

Financial Crisis Inquiry Commission

.36 In May 2009, the Fraud Enforcement and Recovery Act of 2009 was signed into law. This act provides for the establishment of a Financial Crisis Inquiry Commission, which will investigate the causes of the current economic crisis, including

- fraud and abuse, specifically towards consumers.
- the legal and regulatory structure of the U.S. housing market.
- regulatory lapses.
- monetary policy and the availability of terms and credit.
- derivatives (including credit default swaps) markets and practices.
- credit rating agencies.
- short selling.
- accounting policies, specifically fair value accounting and off balance sheet vehicles.
- lending practices and securitization, including the intent to distribute after origination.
- compensation structures in financial entities.

.37 The commission will have 10 members and is modeled on both the National Commission on Terrorist Attacks Upon the United States, known as the 9/11 Commission, and the Great Depression's Pecora Commission. It must report its findings to Congress in December 2010. The commission also will investigate the reasons for each failure of a major financial institution (or major failure prevented by government intervention) from August 2007 to April 2009. Its investigation will occur simultaneously with the sweeping overhaul of the financial system and will likely affect the end result.

Financial Crisis Advisory Group

.38 Although much debate has occurred on the relationship between accounting standards and the economic crisis, one clear takeaway has been the need for improvements to accounting standards. The economic crisis created a loss of confidence in financial reporting. In a step towards satisfying this need, on December 30, 2008, the International Accounting Standards Board (IASB) and FASB announced the creation of the Financial Crisis Advisory Group (FCAG), which had a finite life of approximately 6 months. The principal function of this group is to advise both IASB and FASB about standard setting implications of the global financial crisis and potential changes to the global regulatory environment. This group consists of business and government leaders from around the world. Specifically, the group will consider and discuss the following:

- How improvements in financial reporting could help regain investor confidence in financial markets
- Significant accounting issues that require the urgent and immediate attention of the IASB and FASB, and those that are for long term consideration
- Areas in which financial reporting helped identify issues of concern, or may have created unnecessary concerns, during the credit crisis
- Areas in which financial reporting standards could have provided more transparency to help either anticipate the crisis or respond more timely to the crisis
- The relationship between fair value and off balance sheet accounting and the economic crisis
- The need for due process for accounting standard setters and its implications on resolving emergency issues on a timely and inclusive basis
- The independence of accounting standard setters and governmental actions to the global financial crisis

.39 FCAG also sought written comments from constituents in the early part of 2009 to assist them in making recommendations to FASB and IASB. Comment letters and a summary of the comments can be accessed from FASB's Web site at http://fasb.org/jsp/FASB/Page/SectionPage&cid=1176154540790&pid=1175801889213.

.40 On July 28, 2009, FCAG issued its report containing recommendations related to accounting standard setting activities and other changes to the international regulatory environment following the global financial crisis. In the report, 4 primary principles are addressed: effective financial reporting, limitations of financial reporting, convergence of accounting standards, and standard setter independence and accountability. The report maintains that accounting rules probably understated, rather than overstated, the losses embedded in the financial system. The report also is critical of the pressure put on accounting standard setters during this economic period by politicians and special interest groups. This pressure was a factor that caused both IASB and FASB to change their rules this year, which may decrease public confidence in the standard setters. Further, the FCAG will meet in December to review the progress made on its recommendations. The full text of the report can be accessed at www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156365880.

U.S. Automotive Industry

.41 Late in 2008, then-President George W. Bush announced a $17.4 billion loan package from TARP for General Motors (GM) and Chrysler, 2 of the biggest domestic automakers. The only caveat was that both entities must come up with realistic restructuring plans or else further funding would not be made available to them. A number of issues that had been building for years within the automakers finally put their financial health over the edge: high labor costs, due in part to union contracts, sluggish transition to changing consumer demands such as fuel efficient cars, and poor quality when compared with many foreign automotive manufacturers. The economic crisis was the breaking point; consumers cut down on purchases, including automobiles, for fiscally precautionary reasons and also because credit was not widely available. In October 2008, domestic car sales reached their lowest point in 25 years.

.42 By the end of March 2009, GM and Chrysler had received a total of $30 billion from the U.S. government but had not taken the necessary steps toward good financial health or toward creating a reasonable restructuring plan. President Obama requested the CEO and chairman of GM to step down from his position and requested that Chrysler form a partnership with a foreign car maker in order to receive the next round of funding. Chrysler filed for bankruptcy by the end of April 2009, and on June 1, 2009, GM filed for bankruptcy as well. The restructuring plan for GM includes the U.S. government, at least initially, as the majority stakeholder with a pledge of an additional $30 billion in funding and the United Auto Workers union having up to a 20 percent stake in the entity as well. This contributed to the current nickname for GM, "Government Motors."

.43 The hope is that, after the bankruptcy restructurings, both of these entities will emerge as smaller, more nimble automakers that can keep pace with the competition and be able to repay the government and operate without any additional assistance from them. This will prove challenging for numerous reasons, including the stigma now attached to the names of both GM and Chrysler, the increasing presence of foreign automakers in the United States, new U.S. regulations forcing higher fuel efficiency—the costs of which may not be able to be passed along to the consumer—and shrinking demand due to the economic crisis. At the time of this writing, the industry can make 90 million cars worldwide, but it is selling approximately 55 million.

.44 In its favor, GM has discarded 4 of its 8 brands, Fiat partnered with Chrysler, and the Car Allowance Rebate System (also referred to as Cash for Clunkers) bill was signed into law by President Obama in June 2009. This bill provided government cash incentives between $3,500 and $4,500 for trading in low mileage per gallon (mpg) vehicles for more fuel efficient vehicles. The required differential in mpg for an incentive was as little as 2 in certain instances. For example, owners of sport utility vehicles (SUVs), pickup trucks, or minivans that got 18 mpg or less received a voucher for $3,500 if the new truck or SUV got at least 2 mpg more than their old vehicle. The voucher increased to $4,500 if the mileage of the new truck or SUV got at least 5 mpg more than the older vehicle. Car owners had stricter requirements to qualify—owners received a $3,500 voucher if they traded in a vehicle with original gas mileage of 18 mpg or less for a vehicle that gets at least 22 mpg. The value of the voucher grew to $4,500 if the new car got 10 mpg more than the old vehicle. When the program was launched in late July, the initial $1 billion was used up in a matter of days, with an additional $2 billion approved by the Congress in August 2009. When the program ended in late August, nearly 700,000 new cars were purchased through the program and rebate applications worth $2.877 billion were submitted to the government.

.45 Some observed that this bill was more driven toward increasing SUV sales than providing incentives for fuel efficiency. For example, a car owner who wanted to trade in a vehicle with 20 mpg for one with 35 mpg received no monetary incentive. The big 3 automakers, GM, Chrysler, and Ford, make higher profits on SUVs, and this bill appeared to be geared toward helping them weather the remainder of the economic crisis. Only time will show the fate of

GM and Chrysler and whether the U.S. taxpayers received a good rate of return on their investment in the domestic auto industry.

IRS Guidance for Ponzi Scheme Victims

.46 The Ponzi scheme that came crashing down at Bernard L. Madoff Investment Securities at the end of 2008 is one of many that have surfaced during the economic crisis. The final tally of claims from victims of Madoff surpassed 15,400. During periods of economic strain, Ponzi schemes surface more frequently because many investors request redemptions and fewer buy in. The SEC has charged Madoff's auditor with securities fraud for representing that he had conducted legitimate audits. The SEC also has alleged that the audit firm's sole shareholder (and his family members) had accounts with the Madoff investment firm and received gains on these investments, which would have violated their independence. Further, the SEC alleges that the auditor enabled the Madoff Ponzi scheme by providing unqualified audit opinions stating the audits were performed in accordance with U.S. generally accepted accounting principles (GAAP) and generally accepted auditing standards (GAAS) and that the firm's internal controls were adequate, when none of these assertions were true. Within these assertions, the most important one not tested by the auditors was the existence of the securities purportedly held by Madoff on behalf of the investors. The SEC believes that, had the financial statements been accurately stated in accordance with U.S. GAAP and GAAS, the scheme would have been revealed sooner.

.47 In addition to the SEC investigation, the investors who lost $65 billion needed tax guidance on how to both account for the losses and how to handle the income they had already reported (and thus paid taxes on). The IRS responded by issuing guidance for victims of Ponzi schemes (not just Madoff victims) and their tax preparers, Revenue Ruling 2009-9 and Revenue Procedure 2009-20. The ruling explains the applicable tax law and the procedure offers a safe harbor method of calculating and reporting the losses. It does not appear that an investor who did not invest directly with the fraudulent investment advisor is addressed in this guidance.

.48 Under Revenue Ruling 2009-9, an investor is eligible for a theft loss as opposed to a capital loss. The *theft loss* includes both the lost invested money by the victim and the income they had previously reported in prior year tax returns (for interest, dividends, and so on). Ponzi type theft losses are exempt from the limitations on personal casualty and theft losses, and can be deducted in the year of the fraud discovery, except to the extent there is a claim with a "reasonable prospect of recovery." The determinations regarding the year of discovery and the results of the "reasonable prospect of recovery" test are likely sources of questioning by the IRS. However, a theft loss categorization must be justified in accordance with Revenue Procedures 2009-20 with both the following characteristics:

- The promoter was charged under state or federal law with the commission of fraud, embezzlement, or a similar crime that would qualify as a theft, or was the subject of a state or federal criminal complaint alleging the commission of such a crime.
- Either there was some evidence of guilt by the promoter or a trustee was appointed to freeze the assets of the scheme.

.49 Once a theft loss determination has been made, the taxpayer may generally deduct 95 percent of the net investment in the fraud discovery year, less any actual or expected recovery. The net investment includes the amount invested, less withdrawals, plus the amounts included as income on prior tax returns as income from the investment. These actions put the taxpayer in a safe harbor. However, by doing this the taxpayer agrees not to file amended returns excluding the previously reported income. Subsequent events in future years may require additional income or deductions based on the actual amount of the loss actually recovered. Lastly, any resulting net operating losses may be carried both back and forward. As noted in *Accounting Today* (April 20, 2009)

> Ironically, for at least some of those who entrusted their money to a Ponzi scheme only within the past few years, there is even the possibility that recoveries through [securities investor protector corporation] insurance and theft-loss deductions, as further enhanced by five-year [net operating loss] carryback treatment, may leave them in a better financial situation than many of those who invested in certain legitimate sectors of the crashing stock market.

Accounting Issues and Developments

Fair Value

.50 FASB ASC 820, *Fair Value Measurements and Disclosures*, defines fair value and establishes a framework for measuring fair value; however, it does not dictate when an entity must measure something at fair value, nor does it expand the use of fair value in any way. The need to understand fair value accounting has increased in importance as alternative investments increased in popularity and complexity and as financial markets experience times of illiquidity.

Definition of Fair Value

.51 FASB ASC 820-10-20-5 defines *fair value* as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." The definition retains the exchange price notion in earlier definitions of fair value, but clarifies that the exchange price is the price in a hypothetical transaction at the measurement date in the market in which the reporting entity would transact for the asset or liability. The hypothetical transaction to sell the asset or transfer the liability is considered from the perspective of a market participant that holds the asset or owes the liability. Therefore, the definition of fair value focuses on the price that would be received to sell the asset or paid to transfer the liability (an *exit price*), not the price that would be paid to acquire the asset or received to assume the liability (an *entry price*). Further, FASB ASC 820-10-20 notes, "[c]onceptually, entry prices and exit prices are different. Entities do not necessarily sell assets at the prices paid to acquire them. Similarly, entities do not necessarily transfer liabilities at the prices received to assume them."

.52 A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the *principal market*—the market in which the reporting entity would sell the asset or transfer the liability with the greatest volume and level of activity for the asset or liability—or, in the absence of a principal market, the most advantageous market for the asset or liability. The *most advantageous market* is the market in which the reporting entity would sell the asset of transfer the liability with the price that maximizes the amount that would be received for the asset or minimizes the amount that would be paid to transfer the liability, considering transaction costs in the respective markets.

.53 A fair value measurement of an asset assumes the highest and best use of the asset by market participants, considering the use of the asset that is physically possible, legally permissible, and financially feasible at the measurement date. Highest and best use for an asset is established by one of two valuation premises, *value in use* or *value in exchange*.

.54 If the asset would provide maximum value to market participants principally through its use in combination with other assets as a group (as installed or otherwise configured for use), the highest and best use of the asset is *in use*. For example, value in use might be appropriate for certain nonfinancial assets. An asset's value in use should be based on the price that would be received in a current transaction to sell the asset assuming that the asset would be used with other assets as a group and that those other assets would be available to market participants.

.55 If the asset would provide maximum value to market participants principally on a stand-alone basis, the highest and best use of the asset is *in exchange*. For example, value in exchange might be appropriate for a financial asset. An asset's value in exchange is determined based on the price that would be received in a current transaction to sell the asset standalone.

.56 A fair value measurement for a liability reflects its *nonperformance risk*, the risk that the obligation will not be fulfilled. Because nonperformance risk includes the reporting entity's credit risk, the reporting entity should consider the effect of its *credit risk* (credit standing) on the fair value of the liability in all periods in which the liability is measured at fair value. That effect may differ depending on the liability, for example, whether the liability is a financial liability (deliver cash) or a nonfinancial liability (deliver goods or services), in addition to the terms of any credit enhancements related to the liability.

.57 In June 2009, FASB issued an exposure draft related to applying fair value to interests in alternative investments. This project was added to FASB's agenda in response to recommendations contained in the SEC's study on mark to market accounting, as well as input provided by FASB's Valuation Resource Group. The objective of this guidance is to address the application of FASB ASC 820 (originally issued as FASB Statement No. 157) to interests in alternative investments, such as hedge funds and private equity funds. FASB also is expected to issue the final guidance on this topic in the third quarter of 2009. Constituents should be alert for this issuance.

The Fair Value Hierarchy

.58 FASB ASC 820 emphasizes that fair value is a market based measurement, not an entity specific measurement, and it continues to be a hot topic. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use when pricing the asset or liability (referred to in the statement as inputs), including assumptions about risk. FASB ASC 820-10-35 establishes a fair value hierarchy that distinguishes between (*a*) market participant assumptions developed based on market data obtained from sources independent of the reporting entity (*observable inputs*), and (*b*) the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (*unobservable inputs*). Valuation techniques used to measure fair value should maximize the use of observable inputs and minimize the use of unobservable inputs.

.59 This fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into 3 broad levels:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An *active market* is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and should be used to measure fair value whenever available, except when a reporting entity holds a large number of similar assets or liabilities for which quoted prices might not be readily accessible for, or if a quoted price in an active does not accurately represent fair value at the measurement date (for example, due to a significant event that occurred after the close of a market but before the measurement date). The 2 exceptions are discussed in paragraphs 42–43 of FASB ASC 820-10-35.
- Level 2 inputs are inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly. Adjustments to level 2 inputs will vary depending on factors specific to the asset or liability. An adjustment that is significant to the fair value measurement in its entirety might render the measurement a level 3 measurement, depending on the level in the fair value hierarchy within which the inputs used to determine the adjustment fall. Level 2 inputs include the following:
  - — Quoted prices for similar assets or liabilities in active markets
  - — Quoted prices for identical or similar assets or liabilities in markets that are not active
  - — Inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates)
  - — Inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs)
- Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs should be used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. Unobservable inputs should reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the

asset or liability (including assumptions about risk). The reporting entity's own data used to develop unobservable inputs should be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions.

.60 If an input used to measure fair value under FASB ASC 820 is based on bid and ask prices, the price within the bid-ask spread that is most representative of fair value in the circumstances should be used. This is regardless of where in the fair value hierarchy the input falls. The use of midmarket pricing or other pricing conventions for practical expediency in fair value measurements within a bid-ask spread by an entity is not precluded by this statement.

Disclosures

.61 FASB ASC 820-10-50 discusses the disclosures required for assets and liabilities measured at fair value. For assets and liabilities that are measured at fair value on a recurring basis in periods subsequent to initial recognition or that are measured on a nonrecurring basis in periods subsequent to initial recognition, the statement requires the reporting entity to disclose certain information that enables users of its financial statements to assess the inputs used to develop those measurements. For recurring fair value measurements using significant unobservable inputs (level 3), the reporting entity is required to disclose certain information to help users assess the effect of the measurements on earnings (or changes in net assets) for the period. The qualitative disclosures should be presented using a tabular format, as discussed in the statement. FASB Staff Position (FSP) FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly,* amended FASB Statement No. 157 to require additional disclosures and was codified at FASB ASC 820-10. See the following section, "Measurements of Fair Value in Illiquid Markets," for further details.

.62 In April 2009, FASB released FSP FAS 107-1 and Accounting Principles Board (APB) Opinion No. 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, which has been codified at FASB ASC 270-10-50-1, FASB ASC 320-10, and FASB ASC 825-10-50. This guidance relates to fair value disclosures for all financial instruments held by publicly traded companies that are not currently reflected on the balance sheet of the companies at fair value, regardless of whether the financial instruments are recognized in the balance sheet. Prior to issuing this guidance, fair values for these assets and liabilities were disclosed only once a year. The guidance requires these disclosures to be made each time the entity issues summarized financial information for interim reporting periods, in addition to the disclosures made in annual financial statements. Financial instruments are defined by the FASB ASC glossary and discussed in FASB ASC 825-10-50-8, as cash, evidence of an ownership interest in an entity, or a contract that (*a*) imposes on one entity a contractual obligation to deliver cash or another financial instrument to a second entity or to exchange other financial instruments on potentially unfavorable terms with the second entity, and (*b*) conveys to that second entity a contractual right to receive cash or another financial instrument from the first entity or to exchange other financial instruments on potentially favorable terms with the first entity. An entity must disclose the fair value of all financial instruments for which it is practicable to estimate that value. Fair value information disclosed in the notes should be presented together with the related carrying amount and how the carrying amount relates to what is reported in the statement of financial position. The methods and significant assumptions used to estimate the fair value of financial instruments and any changes in methods and significant assumptions during the period also should be disclosed.

.63 This guidance shall be effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. Early adoption is permitted for periods ending after March 15, 2009. Earlier adoption for periods ending before March 15, 2009, is not permitted. If a reporting entity elects to adopt early either FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, which was primarily codified in FASB ASC 310-55, 325-40, and 320-10, or FSP FAS 107-1 and APB 28-1, which has been codified at FASB ASC 270-10-50-1, 320-10, and 825-10-50, the reporting entity also is required to adopt this FSP early. Additionally, if the reporting entity elects to adopt early, FSP FAS 115-2 and FAS 124-2 also must be adopted early. This FSP does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, this FSP requires comparative disclosures only for periods ending after initial adoption.

Measurements of Fair Value in Illiquid Markets

.64 A contention with fair value accounting guidance was the difficulty of applying fair value in an illiquid or distressed market, such as the current one. This difficulty has the potential to allow inconsistencies in application by accountants and auditors. Prior to the issuance of FSP FAS 157-4, which is codified at FASB ASC 820-10, the areas of the fair value guidance that related to measuring fair value in an illiquid market were limited to the following mentions:

- "An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale)."
- "Market participants are buyers and sellers in the principal (or most advantageous) market for the asset or liability that are ... [w]illing to transact for the asset or liability; that is, they are motivated but not forced or otherwise compelled to do so."
- "For example, a transaction price might not represent the fair value of an asset or liability at initial recognition if ... [t]he transaction occurs under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty."

.65 In response, FASB issued further guidance to help determine fair value in an illiquid market. In October 2008, FSP FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*, was issued. Six months later, in April 2009, FSP FAS 157-4 was issued, which is codified at FASB ASC 820-10. Among other things, FSP FAS 157-4 superseded FSP FAS 157-3. The purpose of FSP FAS 157-4 is to provide additional guidance for estimating fair value in accordance with FASB ASC 820 when the volume and level of activity for the asset or liability have decreased significantly when compared with normal market activity for the asset or liability (or similar assets or liabilities). The new guidance

- affirms that the objective of fair value when the market for an asset or liability is not active is still the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions.
- clarifies and includes additional factors for determining whether there has been a significant decrease in the volume and level of activity for an asset or liability when compared with normal market activity for the asset or liability (or similar assets or liabilities).
- includes guidance for determining fair value based on a nonorderly transaction, an orderly transaction, and a situation in which an entity does not have enough information to conclude whether a transaction is orderly or not. It also adds that an entity would be expected to have sufficient information to conclude whether a transaction is orderly when it is party to the transaction.
- requires an entity to base its conclusion about whether or not a transaction was orderly on the weight of the evidence.
- includes an example that provides additional explanation on estimating fair value when the market activity for an asset has declined significantly.
- requires an entity to disclose a change in valuation technique (and the related inputs) resulting from the application of this guidance and to quantify its effects, if practicable, by major category.
- applies to all fair value measurements except for quoted prices for an identical asset or liability in an active market (that is, a level 1 input).

.66 The new guidance further explains when there has been a significant decrease in the volume and level of activity for an asset or liability, transactions or quoted prices may not be determinative of fair value. In that case, further analysis of the transactions or quoted price is necessary and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value. Additionally, a change in the valuation techniques discussed in FASB ASC 820 or the use of multiple valuation techniques may be appropriate. When using multiple valuation techniques, constituents are reminded that the objective is to determine the point within the fair value estimate range that is most representative of fair value under current market conditions. Regardless of the valuation technique used, risk adjustments are required to be used in the determination of fair value. Risk premiums should be reflective of an orderly transaction between market participants at the measurement date under current market conditions. The guidance also notes that estimating fair value in an inactive market depends on the facts and circumstances and requires the use of significant judgment. However, a reporting entity's intention to hold the asset or liability is not relevant in estimating fair value.

.67 In regards to a quoted price provided by a third party as an input to a fair value estimate, if there has been a significant decline in the volume or level of activity for the asset or liability, an entity should consider whether these third party quoted prices are based on current information from an orderly transaction or if they are based on a valuation technique that reflects market participant assumptions. Additionally, less weight should be placed on third party quotes that do not reflect actual transactions. Further, the nature of the third party quote (for example, whether the quote is an indicative price or a binding offer) should be considered when weighting the available evidence. Third party quotes based on binding offers would carry a greater weight when considering the available evidence.

.68 The new guidance also requires additional disclosures. An entity must disclose in interim and annual periods, the inputs and valuation techniques used to measure fair value and a discussion of changes in valuation techniques and related inputs, if any, during the period. An entity also must define *major category* for equity securities and debt securities to be major security types as described in FASB ASC 942-320-50-2. This requirement is applicable to all equity and debt securities measured at fair value, even if they are not within the scope of FASB ASC 320, *Investments—Debt and Equity Securities* (such as those measured at fair value on a recurring basis in accordance with FASB ASC 946, *Financial Services—Investment Companies*). Any revisions resulting from a change in valuation technique or its application should be accounted for as a change in accounting estimate in accordance with FASB ASC 250-10. In the period of adoption, an entity must disclose a change, if any, in valuation technique and related inputs resulting from the application of this FSP. The entity also must quantify the total effect of the change in valuation technique and related inputs, if practicable, by major category.

.69 This FSP is effective for interim and annual reporting periods ending after June 15, 2009, and is to be applied prospectively. Early adoption is permitted for periods ending after March 15, 2009. Earlier adoption for periods ending before March 15, 2009, is not permitted. If a reporting entity elects to early adopt either FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, which was primarily codified in FASB ASC 310-55, 325-40, and 320-10, or FSP FAS 107-1 and APB 28-1, which has been codified at FASB ASC 270-10-50-1, FASB ASC 320-10, and FASB ASC 825-10-50, the reporting entity also is required to early adopt this FSP. Additionally, if the reporting entity elects to early adopt, FSP FAS 115-2 and FAS 124-2 also must be early adopted. This FSP does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, this FSP requires comparative disclosures only for periods ending after initial adoption.

Measuring Liabilities at Fair Value

.70 On August 27, 2009, FASB issued Accounting Standards Update (ASU) No. 2009-05, *Measuring Liabilities at Fair Value*. This ASU was issued to increase the consistency in the application of FASB ASC 820 to liabilities because many constituents had expressed concern. This ASU applies to all entities that measure liabilities at fair value under FASB ASC 820 and amends sections of FASB ASC 820-10.

.71 This ASU states that, in circumstances in which a quoted price in an active market for the identical liability is not available, fair value of the liability must be measured by either (*a*) a valuation technique that uses the quoted price of the identical liability when traded as an asset or quoted prices for similar liabilities, or similar liabilities when traded as assets, or (*b*) another valuation technique that is consistent with the principles of FASB ASC 820, such as an income approach or a market approach. Further, if there is a restriction on the transference of the liability, the ASU clarifies that an entity is not required to factor that in to the inputs of the fair value determination. Lastly, the ASU also clarifies that a quoted price in an active market for the identical liability, or an unadjusted quoted price in an active market for the identical liability, when traded an asset, are level 1 measurements within the fair value hierarchy. The guidance in this ASU is effective for the first reporting period (including interim periods) beginning after issuance. The full text of the ASU can be accessed from FASB's Web site at www.fasb.org.

Other-Than-Temporary Impairment

The Meaning of Other-Than-Temporary Impairment for Debt Securities

.72 Determining when an investment is other-than-temporarily impaired is another topic that has received increased attention in today's economic environment. FSP FAS 115-1 and FAS 124-1, *The Meaning of* Other-Than-Temporary Impairment *and Its Application to Certain Investments*, as amended by FSP FAS 115-2 and FAS 124-2, is codified in several topics in FASB ASC, including FASB ASC 320 and FASB ASC 325, *Investments—Other*. This guidance addresses the determination of when an investment is considered impaired, whether the impairment is other-than-temporary, and the measurement of the impairment loss. Also included in this amended guidance are accounting issues to be considered subsequent to the recognition of other-than-temporary impairments and related presentation and disclosure considerations. The scope of this amended guidance includes (*a*) debt and equity securities within the scope of FASB ASC 320; (*b*) debt and equity securities within the scope of FASB ASC 958-320 that are held by an investor that reports a performance indicator; and (*c*) equity securities not within the scope of FASB ASC 320 and 958-320 and not accounted for under the equity method, pursuant to FASB ASC 323, *Investments—Equity Method and Joint Ventures*. This guidance does not define the phrase other-than-temporary for available for-sale equity securities; it does, however, discuss accounting treatment for these securities once the determination of being other than temporarily impaired has been made.

.73 The auditor also should be alert for all types of assets that can become impaired, including goodwill, deferred tax assets, and real property. Given the current economic situation, entities should be alert to values of many types of assets on the balance sheet and possible impairment issues. Readers should consult the appropriate accounting requirements for further information.

Recognition and Presentation of Other-Than-Temporary Impairments

.74 On April 9, 2009, FASB released FSP FAS 115-2 and FAS 124-2, which was primarily codified at FASB ASC 310-30, FASB ASC 320-10, and FASB ASC 325-40. The purpose of this FSP is to bring greater consistency to the timing of impairment recognition, and provide greater clarity to investors about the credit and noncredit components of impaired debt securities that are not expected to be sold. Among other points, the FSP

- limits its changes to existing guidance for determining whether an impairment is other-than-temporary to debt securities.
- replaces the existing requirement that the entity's management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert

that it does not have the intent to sell the security or it is more likely than not it will not have to sell the security before recovery of its cost basis.

- incorporates examples of factors from existing literature that should be considered in determining whether a debt security is other-than-temporarily impaired and how those factors interact with the requirement to assert that the entity does not intend to sell the security and it is more likely than not that the entity will not have to sell the security before recovery of its cost basis.
- requires an entity to recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income, when an entity does not intend to sell the security and it is more likely than not that the entity will not have to sell the security before recovery of its cost basis.
- requires an entity to recognize noncredit losses on held to maturity debt securities in other comprehensive income and amortize that amount over the remaining life of the security with no effect on earnings unless the security is subsequently sold or there are additional credit losses.
- includes guidance for debt securities accounted for in accordance with FASB ASC 310-30, stipulating that credit losses should be measured on the basis of an entity's estimate of the decrease in expected cash flows, including those that result from an increase in expected prepayments.
- clarifies that existing premiums or discounts and subsequent changes in estimated cash flows or fair value should continue to be accounted for in accordance with existing guidance (for example, FASB ASC 325-40).
- requires an entity to present the total other-than-temporary impairment in the statement of earnings with an offset for the amount recognized in other comprehensive income.
- requires an entity to present separately in the financial statement where the components of accumulated other comprehensive income are reported and amounts recognized therein related to held-to-maturity and available for-sale debt securities for which a portion of an other-than temporary impairment has been recognized in earnings.
- modifies the disclosure requirements of certain debt and equity securities to require an entity to provide the following:
    - — The cost basis of available for sale and held to maturity debt securities by major security type
    - — The methodology and key inputs, such as performance indicators of the underlying assets in the security, loan to collateral value ratios, third party guarantees, levels of subordination, and vintage, used to measure the portion of an other-than-temporary impairment related to credit losses by major security type
    - — A tabular roll forward of the amount related to credit losses recognized in earnings for debt securities

- modifies previous guidance to require that major security classes be based on the nature and risks of the security and additional types of securities to be included in the list of major security types listed in FASB ASC 942-320-50-2.
- requires the preceding additional disclosures, as well as all prior existing disclosures, for interim periods.

.75 The guidance is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. Earlier adoption for periods ending before March 15, 2009, is not permitted. As discussed previously, if an entity elects to adopt early either FSP FAS 157-4 or FSP FAS 107-1 and APB 28-1, the entity also is required to adopt early this FSP. Additionally, if an entity elects to adopt early this FSP, it is required to adopt FSP FAS 157-4. This FSP does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, this FSP requires comparative disclosures only for periods ending after initial adoption. More information is available at www.fasb.org.

The Meaning of Other-Than-Temporary Impairment for Equity Securities

.76 Soon after the issuance of FSP FAS 115-2 and 124-2 in early April 2009, which focused on other-than-temporary impairment of debt securities, the SEC issued Staff Accounting Bulletin (SAB) No. 111 to amend and replace Topic 5.M in the SAB Series, *Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities*. SAB No. 111 maintains the SEC's previous views related to equity securities and amends Topic 5.M to exclude debt securities from its scope. For available for-sale equity securities, the phrase other-than-temporary impairment should not be interpreted as permanent. When the value of one of these securities has declined, management should investigate the reason. Management should consider all available evidence to evaluate the realizable value of these investment assets. A few examples of factors which, individually or in combination, indicate that declines in value of an available for-sale equity security are other-than-temporary (and therefore a writedown of the carrying value is required) include the following:

- The length of time and the extent to which the market value has been less than cost
- The financial condition and near term prospects of the issuer
- The intent and ability of the holder to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value

.77 Further, unless evidence exists to support a realizable value equal to or greater than the carrying value of the equity security classified as available for sale, a write-down to fair value accounted for as a realized loss should be recorded. This loss should be included in net income in the period it occurs and the written down value of the security becomes the new cost basis.

Impairment Guidance for Beneficial Interests

.78 In January 2009, FSP EITF 99-20-1, *Amendments to the Impairment Guidance of EITF Issue 99-20*, was issued to achieve a more consistent determination of whether an other-than-temporary impairment had occurred. The FSP and EITF 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets," were primarily codified at FASB ASC 325-40. Prior to the issuance of this guidance, there were 2 methods of determining whether an impairment was other-than-temporary. One method was in EITF Issue No. 99-20 and applies to certain beneficial interests and required the use of market participant assumptions about future cash flows. If a debt security was not within the scope of EITF Issue No. 99-20, FASB Statement No. 115 would apply, which does not require exclusive reliance on market participant assumptions about future cash flows.

.79 The scope of the recognition of an other-than-temporary impairment in this FSP includes beneficial interests in debt securities under the scope of EITF Issue No. 99-20. If the fair value of a beneficial interest has declined below its reference amount, this signals the need for an other-than-temporary impairment evaluation. The reference amount equals the initial investment less cash received to date, less other-than-temporary impairments recognized in earnings to date, plus the yield accreted to date.

.80 Further, if, based on current information and events, there has been an adverse change in cash flows expected to be collected from the previously projected cash flows, then an other-than-temporary impairment is deemed to have occurred and the beneficial interest should be written down to fair value with the resulting change being recognized in accordance with the FASB ASC 320, FASB ASC 325, and FASB ASC 958. Determining whether there has been a change in cash flows expected to be collected involves comparing the present value of the remaining cash flows as estimated at the initial transaction date (or the last time revised) against the present value of the cash flows expected to be collected at the current financial reporting date. The discount rate used to calculate the present value of these cash flows should be the current yield used to accrete the beneficial interest.

.81 Only if the present value of the original cash flows, as estimated at the initial transaction date (or the last time revised), is greater than the present value of the remaining cash flows expected to be collected as estimated at the current financial reporting date, the change is considered adverse and an other-than-temporary impairment is deemed to have occurred. An item of note, however, is that, absent any other factors that indicate an other-than-temporary impairment has occurred, changes in the interest rate of a "plain vanilla" variable rate beneficial interest generally should not result in an other-than-temporary impairment.

.82 Readers are encourage to review the guidance contained in both FSP EITF 99-20-1 and FSP FAS 115-2 and FAS 124-2 for a complete understanding of impairment considerations for beneficial securitized interests.

FASB Project on Recoveries of Other-Than-Temporary Impairments

.83 In December 2008, FASB added to the technical agenda a comprehensive project to address the complexity in existing standards of accounting and reporting for financial instruments, which will be undertaken jointly with the IASB. This included a project on recoveries of other-than-temporary impairments. FASB is considering whether an entity should be permitted to reverse, through earnings, a previously recognized other-than-temporary impairment loss if evidence exists that a loss has reversed.

.84 Under current guidance, after an other-than-temporary impairment has occurred, a loss is recognized in earnings for the difference between the cost of the investment and its fair value. The fair value becomes its new cost basis from which future other-than-temporary impairments are determined. Subsequent recoveries are not recognized through earnings. Under international financial reporting standards (IFRSs), reversals of impairment losses through earnings are allowed under certain circumstances for debt securities classified as held to maturity or available for sale. Reversals for equity securities are prohibited.

.85 The scope of the project would include all debt securities classified as held to maturity and available for sale. FASB will coordinate with the IASB and continue deliberations in 2009 on this project.

Changes in Creditworthiness of Derivative Counterparties

.86 FASB ASC 815-20[1] states that an entity should be aware of the derivative counterparty's creditworthiness (and changes therein) in determining the fair value of the derivative instrument. A change in the counterparty's creditworthiness would not necessarily indicate that the counterparty would default on its obligations, but further investigation would be warranted. To conclude, on an ongoing basis, that a hedging relationship is expected to be highly effective in achieving offsetting changes in cash flows (and therefore qualify for hedge accounting), an entity cannot ignore whether it will collect the payments it would be owed under the contractual provisions of the derivative. In making this determination, the effect of any related collateral or financial guarantees also should be considered.

.87 For a cash flow hedge, if the likelihood that the counterparty will not default ceases to be probable, an entity would not be able to conclude that the hedging relationship is expected to be highly effective in achieving offsetting cash flows. For a fair value hedge, a change in the creditworthiness of the derivative counterparty would immediately affect the assessment of whether the relationship qualifies for hedge accounting and the amount of ineffectiveness recognized in earnings under fair value hedge accounting. Especially in the current economic climate, entities should examine their derivative instruments and continuously monitor the creditworthiness of their counterparties and determine the impact on the fair value of the derivatives and the related accounting.

Other Recent Accounting Guidance

.88 On June 30, 2009, FASB issued FASB Statement No. 168. Once this standard is effective, FASB ASC will become the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance issued by the SEC. Also in June 2009, FASB released FASB Statement No. 166, *Accounting for Transfers of Financial Assets,*[2] and FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*,[3] which will change the way entities account for securitizations and special purpose entities starting in 2010. These projects were in response to requests from investors, the SEC, and

[1] Financial Accounting Standards Board (FASB) *Accounting Standard Codification* (ASC) 815-20 contains the guidance originally issued as Derivatives Implementation Group Statement No. 133 Implementation Issue No. G10, *Cash Flow Hedges: Need to Consider Possibility of Default by the Counterparty to the Hedging Derivative*.

[2] At the date of this writing, this guidance has not yet been included in FASB ASC. Readers are encouraged to visit the FASB ASC Web site at http://asc.fasb.org/home and monitor updates.

[3] See footnote 2.

the president's working group on financial markets. Both standards require numerous new disclosures to provide additional transparency about an entity's risks and activities in these areas to investors.

FASB Statement No. 168

.89 FASB Statement No. 168, as codified in FASB ASC 105, *Generally Accepted Accounting Principles*, is effective for financial statements issued for interim and annual periods ending after September 15, 2009. Nonpublic nongovernmental entities that have not previously followed the guidance included in AICPA Technical Questions and Answers (TIS) sections 5100.38–.76 (AICPA, *Technical Practice Aids*), which is now included in FASB ASC as authoritative, should account for the adoption of that guidance as a change in accounting principle, on a prospective basis, for revenue arrangements entered into or materially modified in those fiscal years beginning on or after December 15, 2009, and interim periods within those years. If an accounting change results from the application of this guidance, an entity should disclose the nature and reason for the change in accounting principle in their financial statements. This new standard flattens the U.S. GAAP hierarchy to 2 levels: one that is authoritative (in FASB ASC) and one that is nonauthoritative (not in FASB ASC). Exceptions include all rules and interpretive releases of the SEC under the authority of federal securities laws, which are sources of authoritative U.S. GAAP for SEC registrants, and certain grandfathered guidance having an effective date before March 15, 1992. This statement creates FASB ASC 105.

.90 FASB Statement No. 168 is the final standard that will be issued by FASB in that form. It was added to FASB ASC through ASU No. 2009-02 on June 30, 2009. No new standards in the form of statements, staff positions, EITF abstracts, or AICPA accounting Statements of Position, for example, will be issued. Instead, FASB will issue ASUs. FASB will not consider ASUs as authoritative in their own right. Instead, they will serve only to update FASB ASC, provide background information about the guidance, and provide the basis for conclusions on changes made to FASB ASC.

FASB ASC

.91 On the effective date of FASB Statement No. 168, FASB ASC will become the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance issued by the SEC. At that time, FASB ASC will supersede all then existing, non-SEC accounting and reporting standards for nongovernmental entities. Once effective, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC will become nonauthoritative. This change will affect accountants and auditors alike.

.92 FASB ASC is a major restructuring of accounting and reporting standards designed to simplify user access to all authoritative U.S. GAAP by providing the authoritative literature in a topically organized structure. FASB ASC disassembled and reassembled thousands of nongovernmental accounting pronouncements (including those of FASB, EITF, and the AICPA) to organize them under approximately 90 topics. FASB ASC includes all accounting standards issued by a standard setter within levels A–D of the current U.S. GAAP hierarchy. FASB ASC also includes relevant portions of authoritative content issued by the SEC, as well as select SEC staff interpretations and administrative guidance issued by the SEC; however, FASB ASC is not the official source of SEC guidance and does not contain the entire population of SEC rules, regulations, interpretive releases, and staff guidance.

.93 FASB ASC is not intended to change U.S. GAAP or any requirements of the SEC; rather, it is part of FASB's efforts to reduce the complexity of accounting standards and also to facilitate international convergence. Moreover, FASB ASC does not include governmental accounting standards. The purposes behind the codification project include the following:

- Reduce the amount of time and effort required to solve an accounting research issue
- Mitigate the risk of noncompliance with standards through improved usability of the literature
- Provide accurate information with real time updates as new standards are released
- Assist FASB with the research and convergence efforts required during the standard setting process
- Become the authoritative source of literature for the completed eXtensible Business Reporting Language taxonomy
- Clarify that guidance not contained in FASB ASC is not considered authoritative

.94 FASB ASC uses a topical structure in which guidance is organized into *areas*, *topics*, *subtopics*, *sections*, and *subsections*. These terms are defined as follows:

Areas. The broadest category in FASB ASC, which represent a grouping of topics.

Topics. The broadest categorization of related content, which correlate with the International Accounting Standards (IASs) and IFRSs.

Subtopics. Subsets of a topic, which are generally distinguished by type or scope.

Sections. Categorization of the content into such groups as recognition, measurement, or disclosure. The sections' structure correlates with the IASs and IFRSs.

Subsections. Further segregation and navigation of content below the section level.

.95 Topics, subtopics, and sections are referenced numerically. This organizes the content effectively without regard to the original standard setter or standard from which the content was derived. An example of the numerical referencing is FASB ASC 305-10-05, in which *305* is the *Cash and Cash Equivalents* topic, *10* represents the "Overall" subtopic, and *05* represents the "Overview and Background" section. Constituents are encouraged to begin using FASB ASC, which can be accessed at http://asc.fasb.org/home. To read more about FASB ASC, including recent developments and updates, please see the AICPA's dedicated FASB ASC Web site at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/FASB+Accounting+Standards+Codification/.

Consolidation of Variable Interest Entities

.96 FASB Statement No. 167[4] changes how an enterprise determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated and requires numerous new disclosures.

.97 FASB Statement No. 167 retains the scope of FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* (primarily codified at FASB ASC 810-10), with the addition of entities previously considered qualifying special purpose entities (QSPEs) because the concept of these entities was eliminated in FASB Statement No. 166. This statement requires an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity (VIE). This analysis identifies the primary beneficiary of a VIE as the enterprise that has (*a*) the power to direct the activities of a VIE that most significantly affect the entity's economic performance, and (*b*) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. When considering the first requirement, an enterprise must assess whether it has an implicit financial responsibility to ensure that a VIE operates as designed. It essentially eliminates the quantitative approach previously required for determining the primary beneficiary of a VIE and replaces it with a primarily qualitative analysis.

.98 FASB Statement No. 167 requires ongoing reassessments of whether an enterprise is the primary beneficiary of a VIE. It also amends various other guidance in FASB Interpretation No. 46(R) for determining whether an entity is a VIE. The application of FASB Statement No. 167 may change an enterprise's assessment of which entities it is involved with are VIEs. Further, a reconsideration event for determining whether an entity is a VIE has been added involves changes in facts and circumstances occur such that the holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights of those investments to direct the activities of the entity that most significantly affect the entity's economic performance.

.99 This statement eliminates the exception within FASB Interpretation No. 46(R) that states a troubled debt restructuring under FASB ASC 310-40 and 470-60 (formerly FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*) was not an event that required reconsideration of whether an entity is a VIE and whether an enterprise is the primary beneficiary of a VIE. The enhanced disclosures in FASB Statement No. 167 are required for any enterprise that holds a variable interest in a VIE and will provide financial statement users more transparent information about an enterprise's involvement in a VIE.

.100 This statement nullifies FSP 140-4 and FIN 46(R)-8, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities*, though the content of the enhanced disclosures required by this statement are generally consistent with those previously required by the FSP. This statement is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009,

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[4] See footnote 2 in paragraph 88.

for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Early adoption is not permitted.

.101 FASB Statement No. 167 is expected by some to be the most burdensome of the new FASB statements released. It will force many entities to consolidate previously off balance sheet entities, including past transactions. Essentially, an entity will have to reevaluate all past transactions for possible consolidation. Previous guidance allowed an entity to make an initial determination regarding consolidation and not reconsider it again until an event requiring reevaluation occurred. This analysis also will be employee intensive because there are many past transactions to be reviewed. This analysis will be particularly cumbersome for entities that only invested in certain assets, but did not originate nor service them as they may not have all the necessary information to make a consolidation decision under the new guidance. Further, for any entity under regulatory rules, consolidation of assets may require them to add to their capital reserves.

Accounting for Transfers of Financial Assets

.102 The objective of FASB Statement No. 166[5] is twofold. The first is to address practices that have developed since the issuance of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* which are not consistent with its original intent and key requirements. The second objective is to address financial statement users' concerns that many of the derecognized financial assets (and related obligations) should continue to be reported in the financial statements of transferors. FASB Statement No. 166 amends FASB Statement No. 140 (which was primarily codified at FASB ASC 860, *Transfers and Servicing*) in the following areas:

- It removes the concept of a QSPE from FASB ASC 860 and removes the exception from applying FASB ASC 810 to variable interest entities that are QSPEs;
- It modifies the financial components approach and limits the circumstances in which a transferor derecognizes a portion or component of a financial asset when the transferor has not transferred the original financial asset to an entity that is not consolidated with the transferor in the financial statements being presented or when the transferor has continuing involvement with the financial asset;
- It establishes conditions for reporting a transfer of a portion (or portions) of a financial asset as a sale;
- It defines a participating interest;
- It clarifies that, when applying the conditions in FASB ASC 840-10-40-5, an entity must consider the transferor's continuing involvement with transferred financial assets, including all arrangements or agreements made contemporaneously with, or in contemplation of, a transfer, even if not entered into at the time of the transfer;
- It clarifies the isolation analysis to ensure that the financial asset has been put beyond the reach of the transferor, any of its

[5] See footnote 2 in paragraph 88.

consolidated affiliates included in the financial statements being presented, and its creditors;

- It removes the exception in FASB ASC 860-10-40-5(b)(1) for transfers to QSPEs;
- It requires that a transferor, in a transfer to an entity whose sole purpose is to engage in securitization or asset-backed financing activities, determine whether each third-party holder of a beneficial interest in that entity has the right to pledge or exchange its beneficial interest and that no condition (*a*) constrains the third party beneficial interest holder from taking advantage of its right to pledge or exchange, and (*b*) provides more than a trivial benefit to the transferor;
- It clarifies the principle that the transferor must evaluate whether it directly or indirectly controls the transferred financial asset;
- It requires that a transferor recognize and initially measure at fair value all assets obtained (including a transferor's beneficial interest) and liabilities incurred as a result of an entire financial asset or a group of financial asset accounted for as a sale;
- It removes special provisions for guaranteed mortgage securitizations;
- It removes the fair value practicability exception from measuring the proceeds received by the transferor in a sale accounting transaction at fair value; and
- It requires enhanced disclosures.

.103 FASB Statement No. 166 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. Any existing QSPEs on the effective date must be evaluated for consolidation and, if consolidation is necessary, apply the appropriate transition guidance. The disclosure provisions are applicable to transfers occurring both before and after the effective date.

Subsequent Events

.104 In May 2009, FASB issued FASB Statement No. 165, *Subsequent Events*, which was codified at FASB ASC 855-10. Previously, guidance on subsequent events resided solely in AU section 560, *Subsequent Events* (AICPA, *Professional Standards,* vol. 1), and this statement is intended to be an accounting standard that reflects the underlying principles contained in AU section 560. The objective of the standard is to establish general standards of accounting for and disclosure of events that occur after the balance sheet date, but before financial statements are issued or are available to be issued. This statement applies to the accounting for and disclosure of subsequent events not addressed in other applicable U.S. GAAP (such as FASB ASC 740, *Income Taxes,* and FASB ASC 450, *Contingencies*) and is effective for interim or annual financial periods ending after June 15, 2009, and should be applied prospectively.

.105 The statement defines certain key terms such as subsequent events (including recognized subsequent event and nonrecognized subsequent event), financial statements are issued, and public entity; additionally, it introduces the concept of financial statements being available to be issued. Financial statements are considered available to be issued when they are complete in a form and format that complies with U.S. GAAP and all approvals necessary for issuance have been obtained (for example, from management, the board of directors, and significant shareholders).

.106 An entity must recognize in the financial statements the effects of all material subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. This is analogous to a type I event in AU section 560. Conversely, an entity may not recognize subsequent events that arose after the balance sheet date but before financial statements are issued when such events provide evidence about conditions that did not exist at the date of the balance sheet. This is analogous to a type II event in AU section 560. The statement provides examples of each type of subsequent event.

.107 The statement also requires disclosures about the date through which subsequent events have been evaluated and about certain nonrecognized subsequent events. Reissuance of statements may be necessary in select situations as well, which is discussed further in the guidance.

Contingencies in Business Combinations

.108 In April 2009, FASB issued FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*, which was primarily codified at FASB ASC 805-20. This business combination guidance addresses application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies. The scope includes any asset or liability assumed in a business combination that arise from contingencies that would be within the scope of FASB ASC 450, if not assumed in the context of a business combination, except for those assets and liabilities on which FASB ASC 805, *Business Combinations,* provides specific guidance. The effective date of this guidance coincides with the effective date of FASB ASC 805.

Defensive Intangible Assets

.109 In November 2008, EITF Issue No. 08-7, "Accounting for Defensive Intangible Assets," was released. This issue was codified at FASB ASC 350-30 and applies to acquired intangible assets in situations in which an entity does not intend to actively use the asset but intends to hold (lock up) the asset to prevent others from obtaining access to the asset (a defensive intangible asset), except for intangible assets that are used in research and development activities. An example could be Coca-Cola buying the Pepsi brand name and not producing any products with it.

.110 The classification of an asset as a defensive intangible asset is based upon the intentions of the entity and may change as their intentions change. A defensive intangible asset should be accounted for as a separate unit of accounting and should not be included as part of the cost of an entity's existing intangible asset(s) because it is separately identifiable. The useful life of a defensive intangible asset should be assigned in accordance with FASB ASC 350, *Intangibles—Goodwill and Other*.

.111 This issue is effective for intangible assets acquired on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Examples to illustrate the determination of whether an intangible asset meets the definition of a defensive intangible asset are in FASB ASC 350-30-55-28.

Determining Whether a Financial Instrument is Indexed to an Entity's Stock

.112 In June 2008, EITF Issue No. 07-5, "Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock," was issued to provide guidance on applying the first part of the scope exception in FASB ASC 815-10-15-74(a). EITF Issue No. 07-5 was primarily codified at FASB ASC 815-40. FASB ASC 815-10-15-74 states

> Notwithstanding the conditions of FASB ASC 815-10-15-13 through 15-139, the reporting entity shall not consider the following contracts to be derivative instruments for purposes of this Subtopic: a.) Contracts issued or held by that reporting entity that are both (1) indexed to its own stock and (2) classified in stockholders' equity in its statement of financial position

.113 If an entity determines an instrument or embedded feature has the characteristics of a derivative instrument and is indexed to its own stock, it still must evaluate the second part of the exception, which states that the instrument must be classified in stockholders' equity. For example, a net cash settled stock purchase warrant may be indexed to an entity's own stock, but not classified in stockholders' equity. The guidance in this issue is also applicable to any freestanding financial instrument that is potentially settled in an entity's own stock, regardless of whether the instrument has all the characteristics of a derivative in FASB ASC 815-10-15-83, for purposes of determining whether the instrument is within the scope of FASB ASC 815-40-15.

.114 "Pending Content" in FASB ASC 815-40-15-7 states that, to determine whether an equity linked financial instrument (or embedded feature) is indexed to an entity's own stock, an entity should follow a 2 step approach of first evaluating the instrument's contingent exercise provisions, if any, and second, evaluating the instrument's settlement provisions.

.115 An *exercise contingency*, as defined by FASB ASC glossary, is a provision that entitles the entity (or the counterparty) to exercise an equity linked financial instrument (or embedded feature) based on changes in an underlying, including the occurrence (or nonoccurrence) of a specified event. Examples of exercise contingencies include provisions that accelerate the timing of the entity's (or the counterparty's) ability to exercise an instrument, and provisions that extend the length of time that an instrument is exercisable. An exercise contingency would not preclude an instrument (or embedded feature) from being considered indexed to an entity's own stock unless it is based on (*a*) an observable market, other than the market for the issuer's stock (if applicable), or (*b*) an observable index, other than an index calculated or measured solely by reference to the issuer's own operations. If this evaluation does not preclude an instrument from being considered indexed to the entity's own stock, the analysis should proceed to the second step.

.116 The second step evaluates the provisions of the financial instrument (or embedded feature). If the instrument's settlement amount will equal the difference between the fair value of a fixed number of the entity's equity shares and a fixed monetary amount or a fixed amount of a debt instrument issued by the entity, it would be considered indexed to the entity's own stock. If the instrument's strike price or the number of shares used to calculate the settlement amount are not fixed, the instrument (or embedded feature) would still be considered indexed to an entity's own stock if the only variables that affect the settlement amount are inputs to the fair value of a fixed for fixed forward or option on equity shares. An instrument (or embedded feature) would not be considered indexed to the entity's own stock if its settlement amount is affected by variables that are extraneous to the pricing of a fixed for fixed option or forward contract on equity shares.

.117 EITF Issue No. 07-5 supersedes EITF Issue No. 01-6, "The Meaning of 'Indexed to a Company's Own Stock'"; however, some of the guidance in EITF Issue No. 01-6 was carried forward in EITF Issue No. 07-5. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. Earlier application by an entity that has previously adopted an alternative accounting policy is not permitted.

.118 FASB ASC 815-40-15 provides further implementation guidance, and FASB ASC 815-10-65-3 provides transition guidance and also states that the transition disclosures in paragraphs 1–3 of FASB ASC 250-10-50 should be provided.

Other Accounting and Financial Management Considerations

Liquidity

.119 At a recent KPMG conference, audit committee members were asked to identify the issues that caused them the greatest concern for 2009. Liquidity, access to capital, and cash flow were at the top of the list. During the economic crisis, entities have changed how they examine risk because risks that may have been ignored in the past are now at the top of everyone's concerns. The landscape has changed dramatically and will continue to evolve as the U.S. economy regains its strength. Many entities continue to struggle with liquidity during this difficult economic period and many have already fallen victim to its consequences by becoming insolvent. Some entities have hired chief risk officers (CROs) to specifically manage all risks, while others spread the task among their senior management or general employees. Whether it's the CRO or senior management, new, sophisticated models are being utilized to measure risk. These models have comprehensive probabilistic and scenario based stress tests of an entity's cash flow position over multiple years. Some entities that determined they need to increase cash flow have chosen to divest certain business lines, perhaps those that are noncore to the entity.

.120 One of the driving factors of liquidity concerns is the lack of credit being extended by creditors. For the years leading up to the current recession, credit was flowing freely (which many believe contributed to the economic crisis). This changed dramatically during 2008 and lending has yet to return to even normal levels.

.121 Further, as discussed in the "Audit and Attestation Issues and Developments" section of this alert, TIS section 1100.15, "Liquidity Restrictions" (AICPA, *Technical Practice Aids*), addresses the potential accounting and auditing implications when a fund or its trustee imposes restrictions on a nongovernmental entity's ability to withdraw its balance in a money market fund or other short term investment vehicle.

Credit

.122 One type of entity that has regained its strength during the economic crisis is the lender. When the economy was booming, lenders were under tremendous pressure to cut fees and reduce rates in order to remain competitive and keep their clients. In today's climate, lenders have more control over the situation and are enforcing strict debt covenants more stringently and profiting from their risk spreads. Some commercial lenders are taking advantage of struggling entities by taking possession of superior collateral in exchange for helping the entities maintain their working capital. However, the flip side is that markets for selling such assets are down, which puts the banks in a no win situation. From the creditor's standpoint, when an entity wants to renegotiate loan terms, there is both a capital decision and a credit decision to be made, because many entities' credit rating have diminished during this economic crisis.

.123 To be prepared for this new strength of creditors, there are many items for management to consider when searching for a new loan, including the ratios that will be part of the debt covenants. Whereas banks used to give some padding on covenants in the past, this is becoming less and less frequent given the economic climate. Further, instead of default occurring after two or more periods of missed debt covenants, documents are being written so that one missed debt covenant reporting period is a default. Depending on the entity's financial health, management also should be wary of any positive cash flow covenants. For both of these considerations, management may consider analyzing historical financial data to determine covenants they confidently feel they would be able to meet continually.

.124 Another emerging pattern in the new loan market is an increase of more stringent personal guarantees. Typically, owners who had a 20 percent or higher stake in an entity were required to sign personal guarantees. However, in today's climate, many lenders are requiring personal guarantees from owners who have more than 5 percent ownership in an entity. Borrowers also may want to consider not entering into loans with debt covenants related to fair value of assets; perhaps instead they could be linked to the realization of the assets. Overall, an entity should have an in depth understanding of how loans are structured for comparable entities in their industry and what covenants they would be able to comply with both during a recession and an economic boom.

.125 Lastly, if there is a risk of insolvency on the horizon, management and boards should remember that their fiduciary duty expands to include other parties such as creditors, in addition to shareholders. The zone of insolvency is a legal term for when an entity is in imminent danger of going bankrupt. This poses additional challenges for a struggling entity as shareholders and creditors may have differing demands. Typically, shareholders strive to avoid bankruptcy and creditors strive to preserve capital, which may be achieved by selling assets or liquidating the entity. No bright line exists to determine when an entity has entered the zone of insolvency. The due diligence associated with insolvency tests is similar to a going concern assessment. Once insolvency is identified as an issue, management should test for it regularly. Whenever this risk is present, management should consult the appropriate professionals to determine best next steps.

Disclosures

.126 In the current challenging economic climate, both investors and regulators will be looking for increased disclosures in financial statements. Entities should review prior disclosures to be included in the current period's financial statements to determine if they are still appropriate and not misleading based on the current environment. Entities also should consider the effects of and disclosure of events that occurred after the balance sheet date in accordance with FASB ASC 855-10. Some specific topics entities should consider expanding disclosures on include, but are not limited to, liquidity and capital resources, material impairments, pension plan assets, fair value determinations, critical accounting policies and estimates, risk factors, and relationships with distressed businesses. Another area to consider discussing is the entity's strategy in dealing with current market conditions in addition to how it has been and will continue to be affected by the economic crisis.

.127 Additionally, as described in FASB ASC 275-10-50-8, disclosure regarding an estimate should be made when known information available prior to issuance of the financial statements, or available to be issued, indicates that both of the following criteria are met:

- It is at least reasonably possible (more than remote but less than likely) that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events.
- The effect of the change would be material to the financial statements.

.128 The disclosure should include the nature of the uncertainty and an indication that it is at least reasonably possible that a change in the estimate will occur in the near term. If an entity determines that the preceding criteria are not met due to risk reduction techniques, disclosure is still encouraged, but is not required.

.129 Further, another required disclosure that may be applicable in the current economic environment is vulnerability due to certain concentrations. Disclosures are required if, based on information known by management before the financial statements are issued or are available to be issued, all of the following criteria are met: the concentration exists at the date of the financial statements, the concentrations makes the entity vulnerable to the risk of a near term severe impact, and it is at least reasonably possible that the events that could cause the severe impact will occur in the near term. These disclosures should include information that is adequate to inform users of the general nature of the risk associated with the concentration. Four categories of concentrations that this guidance applies to include concentrations in the volume of business transacted with a particular customer, supplier, lender, grantor, or contributor; concentrations in revenue from particular products, services, or fundraising events; concentrations in the available sources of supply of materials, labor, or services, or of licenses or other rights used in the entity's operations; and concentrations in the market or geographic area in which the entity conducts its operations.

.130 In August 2009, the SEC released an illustrative letter that was sent to certain public companies identifying a number of disclosure issues related to provisions and allowances for loan losses for consideration in the preparation of the Management and Discussion Analysis. This letter can be accessed from the SEC's Web site at www.sec.gov/divisions/corpfin/guidance/loanlossesltr0809.htm.

Fraud Risk Management

.131 In today's economic environment, many entities and their employees are struggling to survive. Although internal control may seem like an area where costs can be curtailed, it is more important than ever to have effective controls against fraud. Periods of economic strain promote more fraud occurrences. Further, studies have shown that small businesses suffer fraud more frequently than larger organizations and experience higher average losses. As a small business, this may be a breaking point and cause the company to go under. The three main types of fraud are asset misappropriations, fraudulent financial statements, and corruption. Asset misappropriation includes payroll fraud and theft of inventory; fraudulent financial statements include misstatements, and corruption, the most common type of fraud, which includes conflicts of interest and the use of bribes. Fraudulent financial statements are the most costly type of fraud—an innocent goal of "making the numbers" may turn into "managing the numbers," which evolves into "making up the numbers." Prepares and auditors alike should be mindful of this progression and any possible warning signs.

.132 Although no internal control system can prevent and detect all fraud, sound internal controls can dramatically decrease the chances a fraud will be perpetrated. To decrease the chances even further, an ethical business culture also should be in place. Prevention begins with effective internal control and also includes adopting structures that decrease motive and restrict opportunity for fraudulent behavior. Fraud detection should include varying procedures, such as analytical procedures, ongoing risk assessment, and trend analysis.

.133 Additionally, fraud deterrence and response also should be focused on by an entity. Some deterrence methods include having a code of ethics, training on ethical standards, and hotlines for reporting unethical behavior. A consistent and comprehensive method to respond to frauds also sends a strong message to employees that it is taken seriously and that actions will be taken against perpetrators. Some effective fraud responses include conducting thorough investigations, disciplining the fraud committers through internal, civil, or criminal action, taking statements from witnesses and suspects, and creating and distributing an annual fraud report to all employees. Fraud deterrence and response coordinate well with the tone at the top. When senior management leads by example, each of these internal controls becomes more effective. By implementing these fraud internal controls effectively, the risk of fraudulent activity occurring will decrease. Paragraph .86 of AU section 316, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1), contains an exhibit that identifies measures entities can implement to prevent, deter, and detect fraud.

Accounting for Losses Due to Fraud

.134 A topic of discussion for management and their auditors is the manner in which losses due to fraud are reflected in the financial statements. Because no accounting standard exists that provides specific guidance on accounting for losses due to fraud, application of professional judgment in this matter can lead to different results. For example, some clients have determined that the losses should be reported in the current period, when the entity became aware of the fraud, whereas others are opting for a restatement of the financial statements for one or more prior periods because they believe the loss in value occurred in a prior period and therefore an adjustment is appropriate. It is important that the auditor understand how the decision was reached and that proper disclosure be made in the financial statements.

.135 Auditors may also consider whether management has properly disclosed or recognized any liability associated with the potential clawback of distributions received from the perpetrator of Ponzi schemes. In the case of Madoff Investment Securities, a possibility exists that the bankruptcy trustee may file lawsuits to recover funds distributed to investors prior to the discovery of the fraud for the purpose of redistributing the funds. Management, in conjunction with appropriate legal counsel, should determine the probability and result of such a lawsuit and disclose or accrue a potential liability as required by FASB ASC 450.

Exposure Draft on Credit Quality and Credit Losses

.136 In late June 2009, FASB issued an exposure draft on *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, which had a comment period through August 24, 2009. This guidance would require enhanced disclosures about the allowance for credit losses and the credit quality of financing receivables and would be applicable for all creditors, including public and nonpublic entities that prepare financial statements in accordance with U.S. GAAP. Under this proposed guidance, there are 6 major categories of disclosures that are disaggregated either by portfolio segment or by class. These categories are allowance for credit losses, rollforward schedules of financing receivables, fair value, credit quality information, impaired financing receivables, and nonaccrual status. Its goal is to provide more information regarding the nature of credit risk inherent in the creditor's portfolio of financing receivables, how that risk is analyzed and assessed in arriving at the allowance for credit losses, and the changes, and reasons for the changes, in both the receivables and the allowance for credit losses. This proposed guidance would be effective beginning with the first interim or annual reporting period ending after December 15, 2009.

IFRS for Small and Medium Sized Entities

.137 In July 2009, the IASB released IFRS designed for use by small and medium sized entities (SMEs) in a 230 page document that contains all applicable accounting and reporting rules (*IFRS for SMEs*). The goal of *IFRS for SMEs* is to ease the financial accounting and reporting requirements on SMEs, especially as IFRSs and U.S. GAAP continue to increase in complexity. *IFRS for SMEs* is aimed at saving these entities money through a cost benefit approach. Additionally, the financial statements are expected to be more relevant to users as the standards were focused on shorter term cash flows, liquidity, balance sheet strength, interest coverage, and solvency issues. Private U.S. entities may also consider adopting these standards due to foreign parent ownership or foreign business relationships. The growing global marketplace will benefit from this as lenders, venture capitalists, and other users would need to understand and work with only one financial accounting and reporting standard for SMEs.

.138 This simplified, abbreviated version of IFRSs is an option for private U.S. entities because the AICPA voted in May 2008 to recognize the IASB as an accounting body for purposes of establishing international financial accounting and reporting principles. This amendment to appendix A of AICPA Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, vol. 2, ET sec. 202 par. .01), and Rule 203, *Accounting Principles* (AICPA, *Professional Standards*, vol. 2, ET sec. 203 par. .01), gives AICPA members the option to use IFRSs as an alternative to U.S. GAAP. Further, by recognizing IASB as an accounting body for purposes of establishing international financial accounting and reporting principles, full IFRSs and *IFRS for SMEs* are not an other comprehensive basis of accounting (OCBOA). Rather, they are GAAP. The AICPA also has developed clarifying language on how audit, review, and compilation reports can be modified when the preparer has used IFRSs. *IFRS for SMEs* does not have an effective date. As such, any professional barrier to using IFRSs and therefore *IFRS for SMEs* has been removed. However, CPAs may need to check with their state boards of accountancy to determine the status of reporting on financial statements prepared in accordance with *IFRS for SMEs* within their individual state.

.139 SMEs are described as entities that publish general purpose financial statements for external users and do not have public accountability. According to the IASB, *public accountability* is when an entity files, or is in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market, or it holds assets in a fiduciary capacity for a broad group of outsiders. Examples of entities that hold assets in a fiduciary capacity include banks, insurance companies, brokers and dealers in securities, pension funds, and mutual funds.

.140 When creating *IFRS for SMEs*, the IASB eliminated many accounting topics that are not generally relevant to private companies (for example, earnings per share and segment reporting). Some of the key differences between U.S. GAAP and *IFRS for SMEs* are the following:

- Disclosures are simplified in a number of areas including pensions, leases, and financial instruments.
- Last in, first out is prohibited.
- Debt covenant violations cannot be cured after the balance sheet date.
- Goodwill and indefinite life intangible assets are amortized over 10 years if reliable estimates cannot be made of their useful lives.
- Depreciation is based on a components approach.
- The temporary difference approach to income tax accounting is simplified.
- Reversal of impairment charges, if certain criteria are met, is allowed.
- Accounting for financial assets and liabilities makes greater use of cost.

.141 Some challenges U.S. entities may face in converting to *IFRS for SMEs* from U.S. GAAP are understanding the differences between *IFRS for SMEs* and U.S. GAAP, the willingness of financial statement users to accept financial statements prepared under *IFRS for SMEs*, working with and accepting a more principles based set of accounting standards compared with the more rules based U.S. GAAP, the impact on taxes and tax planning strategies, and the impact on financial reporting metrics.

Convergence With IFRS

.142 Since the signing of the Norwalk Agreement by FASB and the IASB, the bodies have had a common goal—one set of accounting standards for international use. In this agreement, each body acknowledged its commitment to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. FASB and the IASB have undertaken several joint projects, which are being conducted simultaneously in a coordinated manner to further the goal of convergence of U.S. GAAP and IFRSs. These ongoing joint projects address the conceptual framework, financial statement presentation, and revenue recognition. The "On the Horizon" section of this alert discusses these joint projects. For more information, visit www.fasb.org and www.iasb.org.

IFRS Roadmap

.143 In August 2008, the SEC voted to publish for public comment a proposed roadmap that could lead to the use of IFRSs by U.S. issuers beginning in 2014. The SEC would make a decision in 2011 on whether adoption of IFRSs is in the public interest and would benefit investors. The proposed multiyear plan sets out several milestones that, if achieved, could lead to the use of IFRSs by U.S. issuers in their filings with the SEC. The top 20 companies in each industry, as determined by market capitalization, could elect to begin filing IFRSs financial statements for fiscal periods ending after December 15, 2009. If, in 2011, the SEC adopts IFRSs for all filers, the roadmap suggests mandatory filing for large accelerated filers beginning in 2014, accelerated filers in 2015, and nonaccelerated filers in 2016. The extended comment period ended in April 2009.

.144 The proposed roadmap sets forth seven milestones that will influence the SEC's decision to adopt IFRS for all filers. These milestones relate to the following:

- Improvements in accounting standards
- Accountability and funding of the International Accounting Standards Committee Foundation
- Improvement in the ability to use interactive data for IFRSs reporting
- Education and training relating to IFRSs
- Limited early use of IFRSs when this would enhance comparability for U.S. investors
- Anticipated timing of future rulemaking by the SEC
- Implementation of the mandatory use of IFRSs by U.S. issuers

.145 Additionally, the roadmap discusses 2 alternatives for U.S. issuers that elect to use IFRSs to disclose U.S. GAAP information. Proposal A suggests that a U.S. issuer that elects to file IFRSs financial statements would provide the reconciling information from U.S. GAAP to IFRSs called for under IFRS No. 1, *First-time Adoption of International Financial Reporting Standards*, in a footnote to its audited financial statements. This information would include the restatement of and reconciliation from the prior year's financial statements and related disclosures. Proposal B suggests that U.S. issuers that elect to file IFRSs financial statements would provide the reconciling information from U.S. GAAP to IFRS required under IFRS No. 1 and also would disclose on an annual basis certain unaudited supplemental U.S. GAAP financial information covering a 3 year period. This unaudited supplemental financial information would be in the form of a reconciliation from IFRSs to U.S. GAAP.

.146 The roadmap does not address how the SEC would mandate IFRSs; however, the SEC noted that an option

> would be for the FASB to continue to be the designated standard setter for purposes of establishing the financial reporting standards in issuer filings with the Commission. In this option our presumption would be that the FASB would incorporate all provisions under IFRS, and all future changes to IFRS, directly into generally accepted accounting principles as used in the United States. This type of approach has been adopted by a significant number of other jurisdictions when they adopted IFRS as the basis of financial reporting in their capital markets.

.147 The full text of the roadmap can be viewed on the SEC Web site at http://sec.gov/rules/proposed/2008/33-8982.pdf.

.148 Since the issuance of the roadmap, new SEC Chairman Schapiro has indicated she favors a slowdown of the U.S. adoption of global accounting rules. Users are encouraged to closely monitor the progress of this initiative.

AICPA Launches IFRS.com Web Site

.149 To assist in both awareness building and education, the AICPA launched the new Web site www.ifrs.com in May 2008. The site provides current information about developments in international convergence. Developed by the AICPA, in partnership with its marketing and technology subsidiary CPA2Biz, www.ifrs.com provides a comprehensive set of resources for accounting professionals, auditors, financial managers, audit committees, and other users of financial statements.

.150 The Web site features tools and resources to help CPAs get acquainted with IFRSs, the surrounding issues, and available support. Resources include a history of convergence, a high level overview of the differences between IFRSs and U.S. GAAP, frequently asked questions, articles, textbooks, continuing professional education (CPE) courses and live conference training, helpful links, and assistance for audit committee members.

Audit Risk

.151 In today's economy, it is especially essential that the auditor understand the meaning of audit risk and the interaction of audit risk with the objective of obtaining sufficient appropriate audit evidence. In AU section 312, *Audit Risk and Materiality in Conducting an Audit* (AICPA, *Professional Standards*, vol. 1), *audit risk* is defined broadly as the risk that the auditor may unknowingly fail to appropriately modify his or her opinion on financial statements that are materially misstated. At a time when many entities are going out of business and credit is tight, an unqualified audit opinion, or lack thereof, could have a strong influence on the overall livelihood of an entity.

.152 The auditor's combined assessment of inherent risk and control risk is described as the risks of material misstatement. As noted by paragraph .21 of AU section 312, external circumstances giving rise to business risks also influence inherent risk. In today's challenging environment, certain assertions may have higher inherent risk than they typically do. The auditor should use information gathered by performing risk assessment procedures, including the audit evidence obtained in evaluating the design of controls and determining whether they have been implemented, as audit evidence to support the risk assessment. The auditor should use the risk assessment to determine the nature, timing, and extent of further audit procedures to be performed.

.153 As set forth in paragraph .12 of AU section 312, the auditor may reduce audit risk by determining overall responses and designing the nature, timing, and extent of further audit procedures. Furthermore, paragraph .19 of AU section 312 explains that the auditor should seek to reduce audit risk at the individual balance, class, or disclosure level in such a way that will enable the auditor to express an opinion on the financial statements as a whole at an appropriately low level of audit risk.

Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

.154 AU section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*, vol. 1), establishes requirements and provides guidance about implementing the second standard of field work, as follows: "The auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures." Obtaining this understanding is further complicated and remains at a heightened level of importance by the rapidly changing economic and regulatory environment. In accordance with paragraph .04 of AU section 314, the auditor's primary consideration is whether the understanding that has been obtained is sufficient to assess risks of material misstatement of the financial statements and to design and perform further audit procedures.

.155 The auditor's understanding of the entity and its environment consists of an understanding of the following:

- Industry, regulatory, and other external factors
- Nature of the entity
- Objectives and strategies and the related business risks that may result in a material misstatement of the financial statements
- Measurement and review of the entity's financial performance
- Internal control, which includes the selection and application of accounting policies

.156 Appendix A of AU section 314 contains examples of matters that the auditor may consider in obtaining an understanding of the entity and its environment relating to the categories discussed previously. Understanding the effects of the continued economic crisis on each specific audit client is a key step in designing the audit plan.

.157 Business risks result from conditions, events, circumstances, actions, or inactions that could adversely affect the entity's ability to achieve its objectives and execute its strategies. The setting of inappropriate objectives and strategies also results in business risks. Just as the external environment changes, the handling of the entity's business also is dynamic, and the entity's strategies and objectives change over time. An understanding of business risks increases the likelihood of identifying risks of material misstatement; however, the auditor does not have a responsibility to identify or assess all business risks. Most business risks will eventually have financial consequences and, therefore, an effect on the financial statements; however, not all business risks give rise to risks of material misstatement.

Audit and Attestation Issues and Developments

Audit Risks Arising From Current Economic Conditions

.158 The continued challenging recent economic conditions and regulatory actions may cause additional risk factors that had not existed previously or did not historically have a material effect on audit clients. Some risks that may affect an entity in the continued difficult economic climate are as follows:

- Constraints on the availability of capital and credit
- Going concern and liquidity issues
- Marginally achieving explicitly stated strategic objectives
- Use of off-balance-sheet financing
- Special-purpose entities, joint ventures, or other complex financing arrangements
- Volatile real estate and business markets
- The credit crisis, which can cause significant measurement uncertainty, including accounting estimates and fair value measurements

.159 Although many of these risks are not new to businesses, consideration of the ways a client is affected by external forces is part of obtaining an understanding of the entity and its environment and will allow the auditor to plan and perform the audit to address those risks. As noted in paragraph .17 of AU section 312, some possible audit responses to a significant risk of material misstatement include increasing the extent of audit procedures, performing procedures closer to year-end, or increasing audit procedures to obtain more persuasive evidence. Additionally, given the constantly changing status of economic conditions that could affect your client, auditors should consider modifying audit procedures to ensure that risks are still adequately addressed.

.160 Another key element to examine is management's integrity. This is important during any economic period, but during periods of economic duress, there is an increased likelihood of management acting unethically by violating accounting and reporting rules. Even those who usually have the highest integrity may feel forced into making a poor ethical accounting or reporting decision. Management is always in a position to override any internal controls, engage in collusion, and suppress audit evidence. Auditors should exercise their professional skepticism at a higher level in this current economic climate and not be satisfied with less than persuasive evidence during the audit. Auditors may also consider verifying as many as possible of management's representations. In evaluating the financial statements as a whole, auditors should look for patterns of management being too conservative or too liberal. This may indicate management is attempting to manage earnings by either making the current set of financials look worse or better than they actually are. Motivation may exist for either case. An example of an account management may do this in is the allowance for doubtful accounts.

.161 Further, auditors may consider being less forgiving of errors discovered and more strenuous in their overall audit plan to mitigate the increased risks from the economic crisis. This can be achieved through the materiality calculation, which should consider both quantitative and qualitative factors (such as management's integrity and the economic crisis). It is more important than ever for auditors to document all steps of their audit properly; specifically around how surrounding facts and circumstances bore on their reasoning and the selection of audit methods and procedures. Additionally, considerations used in the design of audit procedures, such as assessing reasonableness of management's judgments and the overall conclusions reached, should be documented thoroughly as well.

.162 Although it is impossible to predict and include all accounting, auditing, and attestation issues that may affect your engagements, in this alert we cover the primary areas of concern given the current economic conditions. Continue to remain alert to economic, legislative, and regulatory developments, as well as the associated accounting, auditing, and attestation issues as you perform your engagements.

Liquidity Considerations

.163 TIS section 1100.15, which continues to have increased relevance in this economy, addresses potential accounting and auditing implications when a fund or its trustee imposes restrictions on a nongovernmental entity's ability to withdraw its balance in a money market fund or other short term investment vehicle. This question and answer section discusses some considerations for when these restriction events occur, such as determining (*a*) whether any assets subject to these restrictions qualify as cash equivalents or current assets; (*b*) whether disclosures about the risks and uncertainties resulting from such restrictions should be made; (*c*) whether these restrictions may trigger violations of debt covenants and, if so, if that liability should be classified as current; (*d*) whether the financial statements need to be adjusted if the occurrence of such restriction occurs between the balance sheet date and the issuance date; and (*e*) whether the restriction events call into question the entity's ability to continue as a going concern.

.164 Auditors should consider whether any additional disclosures made by management include forward-looking statements that are not required by U.S. GAAP and, therefore, may not be audited. Auditors also should consider whether the inability to withdraw funds can pose significant challenges to the entity's liquidity and, therefore, affect the entity's ability to continue as a going concern. Restrictions on liquidity also may be an appropriate matter to communicate to those charged with governance. Finally, the auditor should consider if he or she wishes to emphasize any liquidity restrictions in the auditor's report. For further details, see TIS section 1100.15 at www.aicpa.org/download/acctstd/TIS1100_15.pdf.

Auditing Fair Value Measurements

.165 In addition to understanding the evolving accounting guidance relative to fair value accounting, auditors should be aware of audit issues involving fair value accounting, which remains a hot topic during the economic crisis. Particular assets, liabilities, and components of equity are measured or disclosed at fair value in the financial statements, and it is management's responsibility to make the fair value measurements and disclosures. When auditing these fair values to ensure they are in conformity with GAAP, auditors should consult AU section 328, *Auditing Fair Value Measurements and Disclosures* (AICPA, *Professional Standards*, vol. 1), which establishes standards and provides guidance for auditors. Specific types of fair value measurements are not covered by AU section 328. For example, when auditing the fair value of derivatives and securities, refer to AU section 332, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (AICPA, *Professional Standards*, vol. 1).

.166 In regard to analyzing the sufficiency of the audit evidence, the strongest audit evidence to support a fair value is an observable market price in an active market. If that is not available, a valuation method should incorporate common market assumptions. If common market assumptions are not available or require significant adjustments, the entity may use its own assumptions. The auditor should obtain an understanding of the entity's process for determining fair value measurements and disclosures and of the relevant controls sufficient to develop an effective audit approach. Based on the auditor's assessment of the risks of material misstatement, the auditor should test the entity's fair value measurements and disclosures. Because of the wide range of possible fair value measurements, from relatively simple to complex, and the varying levels of risk of material misstatement associated with the process for determining fair values, the auditor's planned audit procedures can vary significantly in nature, timing, and extent. During this testing, the auditor also may identify any possible indicators of impairment. According to paragraph .23 of AU section 328, substantive tests of the fair value measurements may involve (*a*) testing management's significant assumptions, the valuation model, and the underlying data; (*b*) developing independent fair value estimates for corroborative purposes; or (*c*) reviewing subsequent events and transactions. Paragraph .26 also notes that when testing the fair value measurements and disclosures, the auditor evaluates whether management's assumptions are reasonable and reflect, or are not inconsistent with, market information. In relation to FASB ASC 820, this might include whether the market is distressed, whether the transaction was an orderly transaction, the reasonableness of the determination within the fair value hierarchy of inputs, and the reasonableness of the underlying assumptions.

Fair Values of Securities

.167 The guidance in AU section 332 relating to auditing the fair value of securities is fairly similar to the guidance in AU section 328 and continues to be a hot topic during the economic crisis; however, there are some items of note for the auditor. As previously mentioned, quoted market prices in active markets are the best available audit evidence to support a fair value; however, when they are unavailable and the valuations of securities are obtained from a broker or dealer or another pricing service based on valuation models, the auditor should understand the underlying valuation method used (such as a cash flow projection). These prices also may be based on quoted prices from an active market or other observable inputs that will be a consideration on the auditor's procedures, as well. The process used by the pricing service in measuring fair value should be evaluated to determine the consistency with the specified valuation method (typically fair value, as defined in FASB ASC 820-10-20). The auditor also may determine that it is necessary to obtain quotes from more than one pricing source based on circumstances, such as an existing relationship between the entity and the valuing entity, which could inhibit objective pricing, or underlying valuation assumptions that are highly subjective. In the context of FASB ASC 820, unadjusted quoted prices in active markets are considered level 1 inputs.

.168 When an entity performs its own valuation, value testing procedures include the following:

- Assessing the reasonableness
- Comparing the assumptions with industry reports or benchmarks
- Assessing the appropriateness of the model
- Calculating the value using his or her own model
- Comparing the fair value with subsequent or recent transactions

.169 Whether the inputs to the entity's valuation model are observable determines their characterization as level 2 or level 3 inputs, respectively, within FASB ASC 820. When extensive judgment is needed, consider using a specialist or refer to AU section 342, *Auditing Accounting Estimates* (AICPA, *Professional Standards*, vol. 1). Additionally, when the underlying collateral of a security significantly contributes to its fair value and collectability of the security, evidence of the collateral also should be examined for existence, fair value, transferability, and the investor's right to the collateral.

.170 Paragraph .19 of AU section 328 also notes that the auditor should evaluate whether the entity's method for determining fair value measurements is applied consistently and, if so, whether the consistency is appropriate considering possible changes in the environment or circumstances affecting the entity or changes in accounting principles. The auditor also should evaluate management's conclusions regarding other-than-temporary impairment on its securities and the consistency of these conclusions. Examples of factors that could cause an other-than-temporary impairment, per paragraph .47 of AU section 332, include the following:

- Fair value is significantly below cost and
    - — the decline is attributable to adverse conditions specifically related to the security or to specific conditions in an industry or in a geographic area.
    - — the decline has existed for an extended period of time.
    - — management does not possess both the intent and the ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.
- The security has been downgraded by a rating agency.
- The financial condition of the issuer has deteriorated.
- Dividends have been reduced or eliminated, or scheduled interest payments have not been made.

- The entity recorded losses from the security subsequent to the end of the reporting period.

.171 Auditors must consider all facts and circumstances when determining if an other-than-temporary impairment has occurred. Additionally, the classification of an entity's securities is based on management's intent and ability. The auditor should obtain an understanding of management's classification process among trading, available-for-sale, and held-to maturity, as well as consider the classifications in light of the entity's current financial position.

.172 Further, the auditor should evaluate management's conclusions about the need to recognize an impairment loss. If an impairment loss has been recorded, the auditor should gather evidence supporting the amount of the impairment adjustment recorded and determine whether the entity has followed GAAP.

The Public Company Accounting Oversight Board Staff Audit Practice Alert No. 4

.173 Following the issuances of FSP FAS 157-4, FSP FAS 115-2 and 124-2, and FSP FAS 107-1 and APB 28-1 in April 2009, the Public Company Accounting Oversight Board (PCAOB) issued Staff Audit Practice Alert No. 4, *Auditor Considerations Regarding Fair Value Measurements, Disclosures, and Other-Than-Temporary Impairments* (AICPA, *PCAOB Standards and Related Rules*, PCAOB Staff Guidance, sec. 400.04). These FSPs were codified at FASB ASC 820-10; primarily at FASB ASC 310-55, 325-40, and 320-10; and FASB ASC 270-10-50, 320-10, and 825-10-50, respectively. Auditors operating under PCAOB standards for audits and reviews should be aware that some PCAOB standards include descriptions of accounting requirements that are no longer current. Auditors should disregard descriptions of accounting requirements in PCAOB standards that are inconsistent with the guidance previously mentioned. The PCAOB is planning to remove descriptions of accounting requirements from auditing standards as it replaces or substantively revises its interim standards. Further, the PCAOB has on its agenda to address the auditing standards related to auditing accounting estimates and auditing fair value measurements.

.174 Staff Practice Alert No. 4 also noted that, in accordance with Auditing Standard No. 6, *Evaluating Consistency of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, Rules of the Board, "Standards"), and in relation to a change in accounting principle due to one of these FSPs, "[a] change in accounting principle that has a material effect on the financial statements should be recognized in the auditor's report through the addition of an explanatory paragraph following the opinion paragraph."

.175 This staff audit practice alert also discusses auditor considerations related to reviews of interim financial information, fair value, disclosures, and reporting. The related AU section guidance to these topics is further discussed in this alert.

Auditing Accounting Estimates

.176 As noted in paragraph .04 of AU section 342, the auditor is responsible for evaluating the reasonableness of accounting estimates made by management in the context of the financial statements as a whole. In certain circumstances, an entity is required to separate the amount of other-than-temporary impairment representing credit loss and the amount representing all other factors. An auditor's objective in this scenario would be to obtain sufficient appropriate audit evidence to provide reasonable assurance that these estimates are presented and disclosed in conformity with GAAP. Although this alert has discussed fair value measurements at length, it is important to remember many types of accounting estimates exist in client financial statements. Some examples include the allowance for uncollectible accounts receivable, impairment analysis and estimated useful lives of long lived assets, valuation allowance for deferred tax assets, and actuarial assumptions in pension and other postretirement benefit costs.

.177 Given the current economic climate, additional skepticism should be exercised when considering management's underlying assumptions used in accounting estimates. When evaluating accounting estimates, the auditor should consider both the subjective and objective factors with professional skepticism. As discussed in paragraph .09 of AU section 342, key factors and assumptions that the auditor normally concentrates on include the assumptions that are significant to the estimate, sensitive to variations, deviations from historical patterns, or particularly subjective and susceptible to misstatement and bias; however, it is important to consider whether historical patterns are still applicable.

.178 For example, in the current slow market, new patterns may emerge. In this economic climate, with possible increasing pressure on management to meet earnings, a key aspect of AU section 342 is for an auditor to determine the reasonableness of management's accounting estimates with an extra degree of professional skepticism. As noted in AU section 316, when assessing audit differences between client estimates and audit estimates, even if they are individually reasonable, an auditor should consider whether these differences are indicative of possible bias by management. If so, the auditor should reconsider the estimates as a whole.

.179 The auditor should obtain an understanding of how management develops estimates and should employ one of the approaches outlined in paragraph .10 of AU section 342 in testing that process. In reviewing and testing management's process, the auditor may consider identifying controls around this process and determining if the underlying data used for the estimate are reliable and used appropriately. An auditor also may develop an estimate and compare it with management's estimate. Lastly, the auditor may review subsequent events or transactions occurring prior to the date of the auditor's report. Further, as noted in AU section 316, hindsight may provide the auditor additional insight into the existence of management bias. For further details on auditing estimates, see AU section 342.

Using the Work of a Specialist

.180 It may be necessary to use a specialist (such as a securities valuation expert) to assist in auditing complex or subjective matters, especially during times of economic crisis. Examples of matters in which an auditor may engage a specialist are valuation issues; reasonableness of determination of amounts derived from specialized techniques or models; or implementation of technical requirements, regulations, or legal documents. AU section 336, *Using the Work of a Specialist* (AICPA, *Professional Standards*, vol. 1), provides guidance to auditors in using specialists. The guidance in AU section 336 is applicable when the specialist is hired by management or if the auditor engages the specialist.

However, if a specialist employed by the auditor's firm participates in the audit, AU section 311, *Planning and Supervision* (AICPA, *Professional Standards*, vol. 1), is applicable rather than AU section 336.

.181 When using the work of a specialist, the auditor should evaluate the specialist's professional qualifications, obtain an understanding of the nature of the work performed or to be performed, and evaluate the relationship of the specialist to the client in terms of objectivity. Although the appropriateness and reasonableness of the methods and assumptions employed by the specialist are his or her responsibility, the auditor should obtain an understanding of these qualities, test the underlying data provided to the specialist, and evaluate the specialist's findings in the context of the audit and related assertions in the financial statements.

Interim Financial Information

.182 AU section 722A, *Interim Financial Information* (AICPA, *Professional Standards*, vol. 1), establishes standards and provides guidance on the nature, timing, and extent of the procedures to be performed by an independent accountant when conducting a review of *interim financial information*. *Interim financial information* is defined as financial information or statements covering a period less than a full year or for a 12 month period ending on a date other than the entity's fiscal year-end. AU section 722A will soon be replaced by AU section 722 (and will have the same title as AU section 722A), which will be effective for interim periods within fiscal years beginning after December 15, 2009. AU section 722 was updated to reflect conforming changes due to Statement on Auditing Standards (SAS) No. 116, *Interim Financial Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 722), and has been early adopted by many entities.

.183 As described in paragraph .07 of AU section 722, the objective of a review of interim financial information is to provide the auditor with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for them to conform to the applicable financial reporting framework. Procedures for conducting a review of interim financial information consist principally of analytical procedures and inquiries of persons responsible for financial accounting and reporting matters. In planning a review of interim financial information, the auditor should perform procedures to update his or her knowledge of the entity's business and its internal control to (*a*) aid in the determination of the inquiries to be made and the analytical procedures to be performed, and (*b*) identify particular events, transactions, or assertions to which the inquiries may be directed or analytical procedures applied. This step is especially crucial during periods of economic difficulty because the entity's business may be under strain and a historical understanding of the business may no longer be accurate. In performing analytical procedures, the auditor should consider the reasonableness and consistency of management's responses in light of the results of other review procedures and the auditor's knowledge of the entity's business and its internal control. When inquiring of members of management who have responsibility for financial and accounting matters concerning whether the interim financial information has been prepared in conformity with the applicable financial reporting framework consistently applied, an auditor may consider specifically inquiring about the implementation of fair value accounting guidance to gain further comfort in its application.

.184 As explained by paragraph .21 of AU section 722, a review of interim financial information is not designed to identify conditions or events that may indicate substantial doubt about an entity's ability to continue as a going concern. However, if conditions existed at the date of prior period financial statements or the auditor becomes aware of conditions or events that might be indicative of the entity's possible inability to continue as a going concern, the auditor should

- inquire of management as to its plans for dealing with the adverse effects of the conditions and events, and
- consider the adequacy of the disclosure about such matters in the interim financial information.

.185 Further, it ordinarily is not necessary for the auditor to obtain evidence in support of the information that mitigates the effects of the conditions and events.

.186 Auditors also should determine whether any of the matters described in AU section 380, *The Auditor's Communication With Those Charged With Governance* (AICPA, *Professional Standards*, vol. 1), have been identified during the review of interim financial information. If so, the auditor should communicate them to those charged with governance or be satisfied, through discussion with those charged with governance, that such matters have been communicated to those charged with governance by management. The auditor should determine, for example, that those charged with governance are informed about the process used by management to formulate particularly sensitive accounting estimates about a change in a significant accounting policy affecting the interim financial information and about adjustments that, either individually or in the aggregate, could have a significant effect on the entity's financial reporting process.

Consideration of an Entity's Ability to Continue as a Going Concern

.187 The consideration of an entity's ability to continue as a going concern is required in every audit performed under GAAS and continues to be an especially important consideration in the current state of the economy. An entity's ability to continue as a going concern is affected by many factors related to the current uncertain economy, such as the industry and geographic area in which it operates, the financial health of its customers and suppliers, and financing sources.

.188 As explained by paragraph .02 of AU section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, vol. 1), the auditor's evaluation is based on his or her knowledge of relevant conditions and events that exist at or have occurred prior to the date of the auditor's report. Therefore, this is an ongoing evaluation that extends through the date of the auditor's report.

.189 The auditor has a responsibility to evaluate whether there is a substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. AU section 341 notes that is a period not to exceed one year beyond the date of the financial statements being audited. Some examples of indications that there could be substantial doubt about the ability of the entity to continue as a going concern include, but are not limited to, the following:

- Negative trends such as negative cash flows from operating activities, recurring operating losses, working capital deficiencies, or lack of the ability to obtain additional financing
- Other indications of financial difficulties such as defaults on debt, debt covenants, or both; arrearages in dividends; the need to seek new sources of financing; or the disposal of substantial assets
- Inadequate capitalization
- Internal matters such as turnover in key management positions like CEO, CFO, and controller, or substantial dependence on the success of a particular investment or project
- Entrance into a new market for which the entity might not have the required expertise to compete successfully
- External matters such as market conditions

.190 Audit teams may find it useful to have preliminary discussions about going concern considerations during engagement planning meetings; however, as noted in AU section 341, it is not necessary to design audit procedures around specifically identifying the possibility of a going concern issue because results of typical audit procedures should illuminate any indicators. These procedures may consist of analytical procedures, review of subsequent events, review of compliance with financing agreements, review of board minutes, inquiry of legal counsel, and confirmation with related third parties of the details of arrangements to provide or maintain financial support.

.191 Some risks related to the current state of the economy that may influence an entity's ability to continue as a going concern include the following:

- Lenders may be looking for ways to withdraw from lending relationships.
- Financial support of a related party may not be a feasible mitigating factor, depending on the financial health of that related party.
- An entity's financial health could be significantly weakened if its suppliers or customers have been strongly affected by the economic crisis.
- Projections provided by entities based on historical data may not be reliable future predictions.
- Some entities may be hesitant to include informative and transparent going concern disclosures.

.192 Possible audit responses for each of these respective risks include the following:

- Discussions with management concerning the relationship with the lender and reviewing loan agreements thoroughly
- Determining the viability of the related party to provide financial support and reviewing any formal documentation stating the details of this financial support

- Obtaining a strong understanding of the entity's customers and suppliers and, for any major customer or supplier, considering a review of data supporting their financial health
- Reviewing the projections in detail and considering their reasonableness based upon current economic conditions
- Considering whether financial statement users would consider the disclosures complete

.193 If the auditor believes a substantial doubt about the entity's ability to continue as a going concern exists, the next steps are to obtain management's plans to mitigate the effect of such conditions and then assess the likelihood that these plans can be implemented effectively. Additionally, auditors may consider posing the following questions to help make their assessment of the likelihood of management's plans to successfully mitigate their going concern risk:

- What is the strategy for extending lines of credit or refinancing any debt coming due? Have any preliminary agreements or discussions occurred?
- If negative operating trends exist, how does management plan to turn them around?
- If turnover of key personnel has occurred, what actions are being taken to replace these positions?
- What is the plan to maintain or increase the liquidity of your balance sheet?
- Do any restrictions exist that could limit management's ability to carry out these plans?

.194 If, after considering management's plan, an auditor determines a substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time remains, the auditor should communicate with those charged with governance of the entity, in accordance with AU section 341. In that instance, the auditor also should consider the effects on the entity's financial statements and the adequacy of the related disclosure, and an explanatory paragraph should be added to the audit report following the opinion paragraph.

.195 Alternatively, if management's plan mitigates the risk of the entity's inability to continue as a going concern, the auditor should consider disclosing the primary conditions that gave rise to the initial doubt and management's plans. These disclosures are especially important for financial statement users to fully comprehend the entity's financial strength and ability to continue as a going concern.

.196 The auditor's assessment of whether an entity's ability to continue as a going concern may have a significant impact on an entity's business, either if it is a going concern or if it is not. Because the auditor's professional judgment is frequently the basis for whether a going concern issue exists, it is important that the auditor carefully consider the impact of their judgment on the users of the client's financial statements and to what extent omitting a going concern paragraph would represent risk of material misstatement of the financial statements. Further, a premature going concern paragraph may have detrimental effects on an entity and become a self fulfilling prophecy.

.197 FASB has undertaken a project that will incorporate going concern guidance into accounting literature. One of the expected major changes is regarding the going concern time frame. In its exposure draft, FASB clarifies that the time period for a going concern assessment should not be a bright line 12 months (as it is currently in the auditing guidance); however, it is not intended to be an indefinite look forward period either. This is consistent with the time period in IASs as discussed in the exposure draft.

Consideration of Fraud in a Financial Statement Audit

.198 AU section 316 is the primary source of authoritative guidance about an auditor's responsibilities concerning the consideration of fraud in a financial statement audit. Fraud remains an important issue during the current economic climate. AU section 316 establishes standards and provides guidance to auditors in fulfilling their responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, as stated in paragraph .02 of AU section 110, *Responsibilities and Functions of the Independent Auditor* (AICPA, *Professional Standards*, vol. 1).

.199 Three conditions generally are present when fraud occurs:

- Management or other employees have an incentive or are under pressure, which provides a reason to commit fraud.
- Circumstances exist (for example, the absence of controls, ineffective controls, or the ability of management to override controls) that provide an opportunity for a fraud to be perpetrated.
- Those involved are able to rationalize committing a fraudulent act.

.200 The current economic situation may result in unexpected losses and possibly cause financing or liquidity difficulties for many entities. Additionally, management may be valuing many illiquid securities using inherently subjective methodologies. These situations may provide management additional opportunity and incentive to commit fraud.

.201 As seen in the news recently, a number of frauds that include the three previously mentioned conditions allegedly have occurred. One of those frauds is that of Bernard Madoff Investment Securities. Auditors should ensure they are properly testing for the existence of assets, such as investments, in this scenario. Additionally, auditors should always gain an understanding of the entity's business and how profits are made. In the Madoff case, auditors are being probed about failing to question the strong, consistent annual returns by these investment funds that lacked a clear investment strategy. Because of the characteristics of fraud, the auditor's exercise of professional skepticism is important when considering the risks of material misstatement due to fraud.

.202 Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. The auditor should conduct the engagement with a mindset that recognizes the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity and regardless of the auditor's belief about management's honesty and integrity. Furthermore, professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud has occurred. AU section 316 provides additional information, including ways for the auditor to respond to the risk of material misstatement due to fraud.

Evaluating the Existence of Assets

.203 The Madoff case and other recent fraud investigations bring to light a number of risks that continually need to be considered and responded to by management and auditors. Due to the nature of securities and other financial instruments, determining and testing the ownership and existence of investments has become more difficult. Often, securities and other investments purchased on behalf of an entity are held in the name of a broker organization, which may or may not be a custodian, and custodians generally do not obtain a paper document, only an electronic record of the assets.

.204 Some examples of risks inherent in investment transactions that may be relevant when assessing the existence of investments are as follows:

- The assets involved may not be readily available to physical inspection.
- A lack of effective, independent, third party oversight may exist.
- The information received from a broker organization in the form of monthly statements or in response to audit confirmation requests, may require further verification to assess its reliability.
- A lack of experience on the part of the client may exist with these types of transactions and, therefore, controls over existence may be nonexistent or poorly designed.
- The transactions may be complex in nature, making them difficult to understand.

.205 Management has a responsibility to design an internal control system that is responsive to the risk of existence of assets (in addition to the valuation of assets). As part of their risk assessment procedures, auditors need to assess those controls and determine if the controls have been implemented. Depending on the results of those assessments, the auditor should design an audit strategy that takes into consideration the entity's controls, including testing those controls if those controls are to be relied upon and used as part of the auditor's audit evidence regarding the existence assertion. If the auditor's assessment indicates that management's design or operation of controls is not effective, then those deficiencies should be communicated to those charged with governance if the control deficiency is a significant deficiency or material weakness.

.206 Examples of procedures that can be performed by management that are designed to assess the existence of assets could include the following:

- Obtaining through site visits and documenting an understanding of existence controls placed in operation by any service organization that is utilized by the entity and periodically reassessing that understanding
- Obtaining evidence through direct testing or a SAS No. 70 type 2 report that the service organization's existence controls are appropriately designed and operating effectively
- Inspecting other documentation supporting the entity's interest in the security (for example, correspondence from the broker organization or trustee acknowledging transactions with the fund)

Other Information in Documents Containing Audited Financial Statements

.207 AU section 550, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), provides guidance for the auditor's consideration of other information included in various documents that contain information in addition to audited financial statements and the independent auditor's report thereon. It only is applicable to other information contained in annual reports to holders of securities or beneficial interests, annual reports of organizations for charitable or philanthropic purposes distributed to the public, and annual reports filed with regulatory authorities under the Securities Exchange Act of 1934 or other documents to which the auditor, at the client's request, devotes attention (for example, the "Management's Discussion and Analysis" section of a filing). Further, it is specifically not applicable to Securities Act of 1933 filings and to other information on which the auditor is engaged to express an opinion.

.208 The auditor's responsibility with respect to information in a document does not extend beyond the financial information identified in his report, and the auditor has no obligation to perform any procedures to corroborate other information contained in a document. However, the auditor should read the other information and consider whether such information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements. If the auditor concludes that there is a material inconsistency, the auditor should determine whether the financial statements, the audit report, or both, require revision. If the auditor concludes that they do not require revision, the auditor should request the client to revise the other information. If the other information is not revised to eliminate the material inconsistency, the auditor should consider other actions such as revising the audit report to include an explanatory paragraph describing the material inconsistency, withholding the use of the report in the document, and withdrawing from the engagement. The action will depend on the particular circumstances and the significance of the inconsistency in the other information. Auditors should be aware that this other information may include discussions related to fair value measurements, impairment, and other sensitive topics in the current economic environment.

Communication With Those Charged With Governance

.209 In addition to instances in which communication with those charged with governance in other auditing sections is discussed, other select measures are outlined in AU section 380 that are specifically relevant during an economic crisis and when measuring fair value. AU section 380 establishes standards and provides guidance on the auditor's communication with those charged with governance. As noted in paragraph .05 of AU section 380, the auditor must communicate with those charged with governance matters related to the financial statement audit that are, in the auditor's professional judgment, significant and relevant to the responsibilities of those charged with governance in overseeing the financial reporting process. The auditor should communicate his or her views about the quality of the entity's significant accounting policies, accounting estimates, and financial statement disclosures. For example, as discussed in appendix B of AU section 380, this may include the appropriateness of the accounting policies to the particular circumstances of the entity, the initial selection of, and changes in, significant accounting policies, including the application of new accounting pronouncements, and the effect of significant accounting policies in controversial or emerging areas.

.210 AU section 341 expands on the applicability of AU section 380 when the auditor has concluded that substantial doubt exists about the entity's ability to continue as a going concern. In that case, the auditor should communicate to those charged with governance the nature of the events or conditions identified, the possible effect on the financial statements, the sufficiency of the related disclosures, and the effects on the auditor's report.

Withdrawal of GAAP Hierarchy from Auditing Standards

.211 In August 2009, the AICPA Auditing Standards Board (ASB) voted to withdraw SAS No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles, as amended, from the auditing literature for nonissuers. This SAS was withdrawn as a result of recent pronouncements by FASB, Governmental Accounting Standards Board, and Federal Accounting Standards Advisory Board to incorporate their respective GAAP hierarchies into their respective authoritative literature.

.212 Interpretation No. 3, "The Auditor's Consideration of Management's Adoption of Accounting Principles for New Transactions or Events," of AU section 411 also will be withdrawn automatically because the ASB did not direct that the interpretation be retained and moved elsewhere within the literature.

.213 The effective date of the withdrawal will be September 2009 to reflect the effective date of the FASB ASC, which is effective for financial statements for interim and annual periods ending after September 15, 2009.

.214 Further information about recent ASB projects and activities is available at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Auditing+Standards+Board/.

Recent Pronouncements

.215 AICPA auditing and attestation standards are applicable only to audits and attestation engagements of nonissuers. The PCAOB establishes auditing and attestation standards for audits of issuers. For information on pronouncements issued subsequent to the writing of this alert, please refer to the AICPA Web site at www.aicpa.org, the FASB Web site at www.fasb.org, and the PCAOB Web site at www.pcaob.org. You also may look for announcements of newly issued accounting standards in the *CPA Letter* and the *Journal of Accountancy*.

Recent Auditing and Attestation Pronouncements and Related Guidance

.216 The following table presents a list of recently issued audit and attestation pronouncements and related guidance.

Recent Auditing and Attestation Pronouncements and Related Guidance	
Statement on Auditing Standards (SAS) No. 116, *Interim Financial Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 722) Issue Date: February 2009 (Applicable to audits conducted in accordance with generally accepted auditing standards [GAAS])	This standard amends AU section 722 to accommodate reviews of interim financial information of nonissuers, including companies offering securities pursuant to Securities and Exchange Commission (SEC) Rule 144A or participating in private equity exchanges. It is effective for reviews of interim financial information for interim periods beginning after December 15, 2009. Earlier application is permitted.
SAS No. 115, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325) Issue Date: October 2008 (Applicable to audits conducted in accordance with GAAS)	Replacing SAS No. 112, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325A) this standard defines the terms *deficiency in internal control*, *significant deficiency*, and *material weakness*; provides guidance on evaluating the severity of deficiencies in internal control identified in an audit of financial statements; and requires the auditor to communicate in writing, to management and those charged with governance, significant deficiencies and material weaknesses identified in an audit. It is effective for audits of financial statements for periods ending on or after December 15, 2009. Earlier implementation is permitted.
Statement on Standards for Attestation Engagements (SSAE) No. 15, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements* (AICPA, *Professional Standards*, vol. 1, AT sec. 501) Issue Date: October 2008	This statement establishes requirements and provides guidance that applies when a practitioner is engaged to perform an examination of the design and operating effectiveness of an entity's internal control over financial reporting (examination of internal control) that is integrated with an audit of financial statements (integrated audit). This SSAE is effective for integrated audits for periods ending on or after December 15, 2008. Earlier implementation is permitted.
Interpretation No. 1, "Use of Electronic Confirmations," of AU section 330, *The Confirmation Process*	This interpretation of AU section 330 addresses the use of electronic confirmations.

Recent Auditing and Attestation Pronouncements and Related Guidance	
(AICPA, *Professional Standards*, vol. 1, AU sec. 9330 par. .01–.08) Issue Date: April 2007 Revised Date: November 2008 (Interpretive publication)	
Interpretation No. 7, "Reporting on the Design of Internal Control," of AT section 101, *Attest Engagements* (AICPA, *Professional Standards*, vol. 1, AT sec. 9101 par. .59–.69) Issue Date: December 2008 (Interpretive publication)	This interpretation of AT section 101 addresses how a practitioner may report on the suitability of the design of an entity's internal control over financial reporting for preventing or detecting and correcting material misstatements of the entity's financial statements on a timely basis.
Technical Questions and Answers (TIS) section 1500.07, "Disclosure Concerning Subsequent Events in OCBOA Financial Statements" (AICPA, *Technical Practice Aids*) Issue Date: July 2009 (Nonauthoritative)	This question and answer addresses whether full disclosure financial statements prepared on an other comprehensive basis of accounting should contain the disclosures set forth in Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 855, *Subsequent Events*.
TIS section 1900.01, "Condensed Interim Financial Reporting by Nonissuers" (AICPA, *Technical Practice Aids*) Issue Date: January 2009 (Nonauthoritative)	This question and answer indicates that when preparing condensed interim financial statements, nonissuers may analogize to the guidance in Article 10 of SEC Regulation S-X regarding form and content because Accounting Principles Board (APB) Opinion No. 28, *Interim Financial Reporting*, does not provide a reporting framework. APB Opinion No. 28 is codified primarily at FASB ASC 270, *Interim Reporting*.
TIS section 9150.25, "Determining Whether Financial Statements Have Been Prepared by the Accountant" (AICPA, *Technical Practice Aids*) Issue Date: December 2008 (Nonauthoritative)	This question and answer discusses what an accountant should consider in determining whether he or she has prepared the financial statements of a nonissuer.

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Recent Auditing and Attestation Pronouncements and Related Guidance	
TIS section 1100.15, "Liquidity Restrictions" (AICPA, *Technical Practice Aids*) Issue Date: October 2008 (Nonauthoritative)	This question and answer discusses auditing and accounting issues related to withdrawal restrictions placed on short term investments by a money market fund or its trustee.
Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 6, *Evaluating Consistency of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, Rules of the Board, "Standards") Issue Date: September 2008 (Applicable to audits conducted in accordance with PCAOB standards)	This standard and its related amendments update the auditor's responsibilities to evaluate and report on the consistency of a company's financial statements and align the auditor's responsibilities with FASB Statement No. 154, *Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3*, which is codified at FASB ASC 250, *Accounting Changes and Error Corrections*. This standard also improves the auditor reporting requirements by clarifying that the auditor's report should indicate whether an adjustment to previously issued financial statements results from a change in accounting principles or the correction of a misstatement. It is effective November 15, 2008.
PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence* (AICPA, *PCAOB Standards and Related Rules*, Rules of the Board, "Rules") Issue Date: August 2008 (Applicable to audits conducted in accordance with PCAOB standards)	PCAOB Rule 3526 requires the registered public accounting firm to • describe in writing, to the audit committee of the issuer, all relationships between the registered public accounting firm or any affiliates of the firm and the potential audit client or persons in financial reporting oversight roles at the potential audit client that, as of the date of the communication, may reasonably be thought to bear on independence. • discuss with the audit committee of the issuer the potential effects of any relationships that could affect independence, should they be appointed as the issuer's auditor. • document the substance of these discussions. These discussions should occur at least annually.

Recent Auditing and Attestation Pronouncements and Related Guidance	
	The board also adjusted the implementation schedule for Rule 3523, *Tax Services for Persons in Financial Reporting Oversight Roles* (AICPA, *PCAOB Standards and Related Rules*, Rules of the Board, "Rules"), as it applies to tax services. The board agreed not to apply Rule 3523 to tax services provided on or before December 31, 2008, when those services are provided during the audit period and are completed before the professional engagement period begins. The amendments to Rule 3523 became effective August 28, 2008. The remaining provisions of Rule 3526 became effective on September 30, 2008.
PCAOB Conforming Amendments to the Interim Auditing Standards (AICPA, *PCAOB Standards and Related Rules*, Rules of the Board, "Standards") Issue Date: November 15, 2008 (Applicable to audits conducted in accordance with PCAOB standards)	In conjunction with the PCAOB's adoption of Auditing Standard No. 6, the PCAOB also adopted a number of conforming amendments to its interim standards. The conforming amendments can be found in appendix 2 of PCAOB Release No. 2008-001 at www.pcaob.org/Rules/Docket_023/PCAOB_Release_No._2008-001_–_Evaluating_Consistency.pdf.
PCAOB Staff Audit Practice Alert No. 4, *Auditor Considerations Regarding Fair Value Measurements, Disclosures, and Other-Than-Temporary Impairments* (AICPA, *PCAOB Standards and Related Rules*, PCAOB Staff Guidance, sec. 400.04) Issue Date: April 2009 (Applicable to audits conducted in accordance with PCAOB standards)	This staff audit practice alert is designed to inform auditors about potential implications of the FASB Staff Positions on reviews of interim financial information and annual audits. This alert addresses the following topics: • Reviews of interim financial information • Audits of financial statements, including integrated audits • Disclosures • Auditor reporting considerations

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Recent Auditing and Attestation Pronouncements and Related Guidance	
PCAOB Staff Audit Practice Alert No. 3, *Audit Considerations in the Current Economic Environment* (AICPA, *PCAOB Standards and Related Rules*, PCAOB Staff Guidance, sec. 400.03) Issue Date: December 2008 (Applicable to audits conducted in accordance with PCAOB standards)	This practice alert is designed to assist auditors in identifying matters related to the current economic environment that might affect audit risk and require additional emphasis. The practice alert addresses the following six main areas: overall audit considerations, auditing fair value measurements, auditing accounting estimates, auditing the adequacy of disclosures, auditor's consideration of a company's ability to continue as a going concern, and additional audit considerations for selected financial reporting areas.

Recent Accounting Pronouncements and Related Guidance

.217 The following table presents a list of recently issued accounting pronouncements and related guidance.

Recent Accounting Pronouncements and Related Guidance	
Financial Accounting Standards Board (FASB) *Accounting Standards Codification*™ (ASC) Accounting Standard Update (ASU) No. 2009-05 (August 2009)	*Fair Value Measurements and Disclosures (Topic 820)—Measuring Liabilities at Fair Value*
FASB ASC ASU No. 2009-04 (August 2009)	*Accounting for Redeemable Equity Instruments—Amendment to Section 480-10-S99*
FASB ASC ASU No. 2009-03 (August 2009)	*SEC Update—Amendments to Various Topics Containing SEC Staff Accounting Bulletins*
FASB ASC ASU No. 2009-02 (June 2009)	*Omnibus Update—Amendments to Various Topics for Technical Corrections*
FASB ASC ASU No. 2009-01 (June 2009)	*Topic 105—Generally Accepted Accounting Principles—amendments based on—Statement of Financial Accounting Standards No. 168—The FASB Accounting Standards Codification*™ and the Hierarchy of Generally Accepted Accounting Principles

Recent Accounting Pronouncements and Related Guidance	
FASB Statement No. 168 (June 2009) (Codified at FASB ASC 105, *Generally Accepted Accounting Principles*)	*The* FASB Accounting Standards Codification™ *and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162*
FASB Statement No. 167[6] (June 2009)	*Amendments to FASB Interpretation No. 46(R)*
FASB Statement No. 166[7] (June 2009)	*Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140*
FASB Statement No. 165 (May 2009) (Codified at FASB ASC 855, *Subsequent Events*)	*Subsequent Events*
FASB Statement No. 164[8] (May 2009)	*Not-for-Profit Entities: Mergers and Acquisition—Including an amendment of FASB Statement No. 142*
FASB Statement No. 163 (May 2008) (Codified at FASB ASC 944, *Financial Services—Insurance*)	*Accounting for Financial Guarantee Insurance Contracts—an interpretation of FASB Statement No. 60*
FASB Statement No. 162 (May 2008)	*The Hierarchy of Generally Accepted Accounting Principles*
FASB Emerging Issues Task Force (EITF) Issues (Various dates)	Go to www.fasb.org/eitf/agenda.shtml for a complete list of EITF Issues.
FASB Staff Positions (FSPs) (Various dates)	Go to www.fasb.org/fasb_staff_positions/ for a complete list of FSPs.
Technical Questions and Answers (TIS) section 6910.30, "Disclosure Requirements of Investments for Nonregistered Investment Partnerships When Their Interest in an Investee Fund Constitutes Less Than 5 Percent of the Nonregistered Investment Partnership's Net Assets" (AICPA, *Technical Practice Aids*)	This question and answer discusses the disclosure requirements for investments for nonregistered investment partnerships.
Issue Date: August 2009 (Nonauthoritative)	

(continued)

[6] See footnote 2 in paragraph 88.
[7] See footnote 2 in paragraph 88.
[8] See footnote 2 in paragraph 88.

Recent Accounting Pronouncements and Related Guidance	
TIS section 6910.31, "The Nonregistered Investment Partnership's Method for Calculating Its Proportional Share of Any Investments Owned by an Investee Fund in Applying the '5 Percent Test' Described in TIS Section 6910.30" (AICPA, *Technical Practice Aids*) Issue Date: August 2009 (Nonauthoritative)	This question and answer discusses the method of determining the application of TIS section 6910.30 to nonregistered investment partnerships.
TIS section 6910.32, "Additional Financial Statement Disclosures for Nonregistered Investment Partnerships When the Partnership Has Provided Guarantees Related to the Investee Fund's Debt" (AICPA, *Technical Practice Aids*) Issue Date: August 2009 (Nonauthoritative)	This question and answer discusses additional disclosures required for nonregistered investment partnerships.
TIS section 1600.04, "Presentation of Assets at Current Values and Liabilities at Current Amounts in Personal Financial Statements" (AICPA, *Technical Practice Aids*) Issue Date: June 2009 (Nonauthoritative)	This question and discusses the definitions of *current values* and *current amounts* for personal financial statements.
TIS section 6931.11, "Fair Value Measurement Disclosures for Master Trusts" (AICPA, *Technical Practice Aids*) Issue Date: March 2009 (Nonauthoritative)	This question and answer indicates that the disclosures required by paragraphs 32–34 of FASB Statement No. 157, *Fair Value Measurements*, are required for individual investments under a master trust arrangement and are not required for the plan's total interest in the master trust.
TIS section 6995.02, "Evaluation of Capital Investments in Corporate Credit Unions for Other-Than-Temporary Impairment" (AICPA, *Technical Practice Aids*) Issue Date: February 2009 (Nonauthoritative)	This question and answer highlights the authoritative literature that helps a corporate credit union evaluate its membership capital shares and paid-in capital in the U.S. Central Federal Credit Union for other-than-temporary impairment charges at December 31, 2008.

Recent Accounting Pronouncements and Related Guidance	
TIS section 6995.01, "Financial Reporting Issues Related to Actions Taken by the National Credit Union Administration on January 28, 2009 in Connection With the Corporate Credit Union System and the National Credit Union Share Insurance Fund" (AICPA, *Technical Practice Aids*) Issue Date: January 2009 (Nonauthoritative)	This question and answer presents alternative views regarding whether the actions of the National Credit Union Administration constitute a type 1 or type 2 subsequent event with regard to the valuation of a federally insured credit union's National Credit Union Share Insurance Fund deposit at December 31, 2008. Additionally, this question and answer presents alternative views on when and how the obligation for the insurance premium should be recognized for financial reporting purposes.
TIS section 6910.29, "Allocation of Unrealized Gain (Loss), Recognition of Carried Interest, and Clawback Obligations" (AICPA, *Technical Practice Aids*) Issue Date: January 2009 (Nonauthoritative)	This question and answer discusses how cumulative unrealized gains (losses), carried interest, and clawback should be reflected in the equity balances of each class of shareholder or partner at the balance sheet date when preparing financial statements of an investment partnership, in accordance with U.S. generally accepted accounting principles, in which capital is reported by investor class. In particular, this question and answer asks if cumulative period-end unrealized gains and losses should be allocated as if realized in accordance with the partnership's governing documents prior to the date, time, or event specified in the partnership agreement.
TIS section 1900.01, "Condensed Interim Financial Reporting by Nonissuers" (AICPA, *Technical Practice Aids*) Issue Date: January 2009 (Nonauthoritative)	This question and answer indicates that when preparing condensed interim financial statements, nonissuers may analogize to the guidance in Article 10 of SEC Regulation S-X regarding form and content because Accounting Principles Board (APB) Opinion No. 28, *Interim Financial Reporting*, does not provide a reporting framework. APB Opinion No. 28 is codified primarily at FASB ASC 270, *Interim Reporting*.

(continued)

Recent Accounting Pronouncements and Related Guidance	
TIS section 6300.36, "Prospective Unlocking" (AICPA, *Technical Practice Aids*) Issue Date: December 2008 (Nonauthoritative)	This question and answer discusses when an insurance company may change its original policyholder benefit liability assumptions.
TIS section 1100.15, "Liquidity Restrictions" (AICPA, *Technical Practice Aids*) Issue Date: October 2008 (Nonauthoritative)	This question and answer discusses auditing and accounting issues related to withdrawal restrictions placed on short term investments by a money market fund or its trustee.

Recent AICPA Independence and Ethics Pronouncements

.218 Audit Risk Alert *Independence and Ethics Developments—2009* (product no. 0224709) contains a complete update on new independence and ethics pronouncements. This alert will heighten your awareness of independence and ethics matters likely to affect your practice. Obtain this alert by calling the AICPA at (888) 777-7077 or visiting www.cpa2biz.com.

On the Horizon

.219 Auditors should keep abreast of auditing and accounting developments and upcoming guidance that may affect their engagements. The following sections present brief information about some ongoing projects that have particular significance in the current state of the economy. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for departures from existing standards.

.220 The following table lists the various standard setting bodies' Web sites, through which information may be obtained on outstanding exposure drafts, including downloading exposure drafts. These Web sites contain in-depth information about proposed standards and other projects in the pipeline. Many more accounting and auditing projects exist in addition to those discussed here. Readers should refer to information provided by the various standard setting bodies for further information.

Standard Setting Body	*Web Site*
AICPA Auditing Standards Board	www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Auditing+Standards+Board/
Financial Accounting Standards Board	www.fasb.org
Professional Ethics Executive Committee	www.aicpa.org/Professional+Resources/Professional+Ethics+ Code+of+Professional+Conduct/Professional+Ethics/
Public Company Accounting Oversight Board	www.pcaob.org
Securities and Exchange Commission	www.sec.gov

Auditing and Attestation Pipeline—Nonissuers

Auditing Standards Board Clarity Project

.221 In response to growing concerns about the complexity of standards, the ASB has commenced a large scale clarity project to revise all existing auditing standards so they are easier to read and understand. Over the next 2 or 3 years, the ASB will be redrafting all of the existing auditing sections contained in the *Codification of Statements on Auditing Standards* (AU sections of the AICPA's *Professional Standards*) to apply the clarity drafting conventions and converge with the International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB). The ASB proposes that, except to address current issues, all redrafted standards will become effective at the same time. Only those standards needing to address current issues would have earlier effective dates. The ASB believes that a single effective date will ease the transition to, and implementation of, the redrafted standards. The effective date will be long enough after all redrafted statements are finalized to allow sufficient time for training and updating of firm audit methodologies. Currently, the date is expected to be for audits of financial statements for periods beginning no earlier than December 15, 2010. This date depends on satisfactory progress being made and will be amended, should that prove necessary. See the explanatory memorandum "Clarification and Convergence" and the discussion paper *Improving the Clarity of ASB Standards* at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Improving+the+Clarity+of+ASB+Standards.htm.

Exposure Draft to Revise Standards for Compilation and Review Engagements

.222 The Accounting and Review Services Committee (ARSC) issued an exposure draft that would revise the standards for compilation and review engagements. The changes would affect the interplay between the standards and independence rules, permitting an accountant to issue a review report on financial statements when the accountant's independence is impaired by performing certain nonattest services (described in the exposure draft as internal control services) that were designed to improve the reliability of the client's financial information.

.223 The exposure draft includes a trio of proposed standards: Framework and Objectives for Performing and Reporting on Compilation and Review Engagements, Compilation of Financial Statements, and Review of Financial Statements. In drafting the proposed standards, the ARSC considered recommendations from the Private Company Practice Section (PCPS) Reliability Task Force. The ARSC and PCPS believe the proposed standards will respond to many concerns of smaller business owners, users of small business financial statements, and CPAs who serve smaller entities.

.224 The PCPS task force recommended that the ARSC consider revising its standards for situations in which an accountant's independence is impaired in connection with the performance of a nonattest service relating to the design or operation of an aspect of internal control over financial reporting. These nonattest services help management prepare higher quality or more reliable financial statements.

.225 The proposed standards also would harmonize the AICPA's review standard with the IAASB's review standard International Standard on Review Engagements No. 2400, *Engagements to Review Financial Statements*.

.226 Significant proposed changes to the Statements on Standards for Accounting and Review Services include the following:

- The introduction of new terms such as *moderate assurance*, *review evidence*, and *review risk*, to the review literature to harmonize with international review standards.
- A discussion of materiality in the context of a review engagement.
- A requirement that an accountant establish an understanding with management regarding the services to be performed through a written communication (that is, an engagement letter).
- The establishment of enhanced documentation requirements for compilation and review engagements.
- Guidance for practitioners who are engaged to perform a compilation or review engagement when they also have been engaged to perform nonattest services. The guidance includes reporting requirements for instances in which the accountant's independence is impaired due to the performance of these services.
- The ability for an accountant to include a general description in the accountant's compilation report regarding the reason(s) for an independence impairment.

.227 The comment deadline was July 31, 2009. The proposed effective date is for compilations and reviews of financial statements for periods beginning on or after December 15, 2010. Early application would be permitted. For further information on this project, visit www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/ARSC+Reliability+Project.htm.

Implementation Guidance for Compilation and Review Standards

.228 The AICPA is working on several products to further your knowledge of the new compilation and review standards. The first product is our annual alert *Compilation and Review Engagements—2009*. This alert provides an annual update on issues affecting compilation and review engagements and will focus on the proposed new standards, among other issues affecting practitioners performing compilation and review engagements. This alert is scheduled to be released in December 2009, just in time for your 2009 compilation and review engagement planning. The second product is a new alert titled *Understanding the Revised Standards for Performing Compilation and Review Engagements*. This alert will be released shortly after the new standards are finalized in early 2010 and will focus on information for entities expecting to early adopt the new standards. The last product is a brand new AICPA Guide titled *Compilation and Review Engagements*, which will provide additional information on implementing the new compilation and review standards and understanding internal control services. It also will include illustrative letters, sample reports, and case studies. This guide is expected to be available in spring 2010. See www.cpa2biz.com for further information.

Auditing and Attestation Pipeline—Issuers

PCAOB Risk Assessment Standards

.229 In October 2008, the PCAOB proposed 7 new auditing standards to update and supersede the current risk assessment standards. The PCAOB chairman noted that the proposals demonstrate the view that the risk of fraud is a central part of the audit process and not a separate consideration. The proposed standards integrate the risk assessment standards with the standard for the audit of internal control over financial reporting. Many of the IAASB's risk assessment standards were utilized in creating these proposed standards, and efforts were made to reduce any unnecessary differences. These proposed standards each have a statement of objective for the auditor, which was loosely adapted from the ISAs. This is an example of the move in the United States from rules-based to principles-based accounting and auditing standards because these objectives do not state required outcomes. The 7 proposed standards are as follows:

- Audit Risk in an Audit of Financial Statements
- Audit Planning and Supervision
- Identifying and Assessing Risks of Material Misstatement
- The Auditor's Responses to the Risks of Material Misstatement
- Evaluating Audit Results
- Consideration of Materiality in Planning and Performing an Audit
- Audit Evidence

.230 In February 2009, the Center for Audit Quality (CAQ) issued a comment letter on the proposed standards. Readers can review the full text of the comment letter at http://thecaq.org/newsroom/pdfs/CAQCommentLetter-PCAOBRiskAssessmentAuditStds.pdf. The comment period for these proposed standards ended in February 2009. As with any new auditing standard or amendment to a PCAOB standard, after adoption by the PCAOB, the standards will be submitted to the SEC for approval.

Engagement Quality Review

.231 In March 2009, the PCAOB reproposed an auditing standard on engagement quality review for public comment. The PCAOB made substantial changes to the proposed auditing standard because it was first proposed in February 2008. The proposal would supersede the PCAOB's current audit quality control standard and would apply to all audit engagements and engagements to review interim financial information conducted pursuant to the standards of the PCAOB. The proposed standard provides a framework for an engagement quality reviewer to objectively evaluate the significant judgments made by the engagement team and the conclusions reached in forming an overall conclusion about the engagement. In July 2009, the PCAOB voted to adopt this standard as Auditing Standard No. 7, *Engagement Quality Review*. This standard will be effective, subject to SEC approval, for both engagement quality reviews of audits and interim reviews for fiscal years beginning on or after December 15, 2009.

Concept Release on Audit Confirmations

.232 In April 2009, the PCAOB issued a concept release for public comment on possible revisions to AU section 330, *The Confirmation Process* (AICPA, *Professional Standards,* vol. 1). Confirmations are typically an important source of evidence for auditors as independent third party sources verify the data on the confirmation. The PCAOB's concept release addresses the following 9 areas of possible change to the current confirmation guidance:

- Expands the definition of confirmation to include direct access to information held by a third party
- Establishes a presumption that the auditor will request the confirmation of accounts receivable
- Discusses factors to consider in designing confirmation requests
- Updates the requirement for maintaining control over confirmation requests for the advances in technology
- Provides further direction on evaluating the reliability of confirmation responses
- Eliminates the ability for the auditor to omit performing alternative procedures for nonresponses to positive confirmation requests
- Considerations for when management requests an auditor to not confirm a select account, transaction, and so on
- Conducts an evaluation of disclaimers and restrictive language on confirmation responses
- Considers whether the use of negative confirmations should continue to be allowed

.233 Generally speaking, the concept release does not contemplate major changes to the confirmation process; rather it addresses developments in technology and related risk factors. Comments were due back to the PCAOB by the end of May 2009. Readers should be alert to developments on this issue.

Accounting Pipeline

FASB and IASB Memorandum of Understanding

.234 In September 2008, FASB and the IASB updated their "Memorandum of Understanding" (MoU), originally published in 2006, to reaffirm their respective commitments to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. In developing the original MoU, FASB and the IASB agreed on priorities and established milestones as part of a joint work program to develop new common standards that improve the financial information reported to investors. FASB and the IASB agreed that the goal of joint projects is to produce common, principles-based standards, subject to the required due process. In the MoU, the boards identified the following 11 convergence topics on which to focus:

- Business combinations
- Financial instruments
- Financial statement presentation
- Intangible assets
- Leases
- Liabilities and equity distinctions
- Revenue recognition
- Consolidations
- Derecognition
- Fair value measurement
- Postemployment benefits (including pensions)

.235 Both FASB and the IASB note that their individual and joint efforts are not limited to the preceding items, but they remain committed to the MoU. FASB and the IASB also have several other joint projects in process, including the conceptual framework project, emissions trading schemes, insurance contracts, and income taxes.

.236 Readers also are encouraged to monitor developments on the AICPA's Web site, www.ifrs.com, in addition to the FASB, IASB, and SEC Web sites. The growing acceptance of IFRSs as a basis for U.S. financial reporting could represent a fundamental change for the U.S. accounting profession.

Going Concern FASB Project

.237 Currently, the only guidance on going concern resides in the auditing literature and this project's intention is to incorporate going concern guidance into U.S. GAAP. Specifically, this guidance would discuss

- preparation of financial statements as a going concern.
- an entity's responsibility to evaluate its ability to continue as a going concern.
- disclosure requirements when financial statements are not prepared on a going concern basis.
- disclosure requirements when there is a substantial doubt as to an entity's ability to continue as a going concern.

.238 A draft of the proposed statement was released and commented on late in 2008. In a February 2009 board meeting, FASB discussed the comments received on the proposal and decided to provide guidance that defines a going concern and clarifies that the period for the going concern assessment is not a strict 12 month period nor is it intended to be an indefinite look forward period. Readers should be alert to the issuance of this guidance.

Loss Contingency FASB Project

.239 Another project on FASB's agenda is disclosure of certain loss contingencies, which will enhance the disclosure requirements for loss contingencies recognized under FASB ASC 450. An exposure draft was released and commented on during 2008. The statement would

- expand the population of loss contingencies that are required to be disclosed.
- require disclosure of specific quantitative and qualitative information about those loss contingencies.
- require a tabular reconciliation of recognized loss contingencies to enhance financial statement transparency.
- provide an exemption from disclosing certain required information if disclosing that information would be prejudicial to an entity's position in a dispute.

.240 FASB believes these requirements would significantly improve the overall quality of disclosures about loss contingencies by providing financial statement users with important information.

.241 The concerns raised by constituents during the comment period prompted FASB to work on preparation of an alternative model to the guidance in the exposure draft. Both the original model and the alternative model will be field tested by FASB. FASB will begin redeliberation in the third quarter of 2009. The final statement will be effective no sooner than for fiscal years ending after December 15, 2009. Readers should be alert for developments on this topic.

FASB Interpretation No. 48 Private Entity Applicability FASB Project

.242 FASB had 2 phases for the FASB Interpretation No. 48 Private Entity Applicability project. The first has been completed with the issuance of FSP FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*. This FSP defers the effective date of FASB Interpretation No. 48 (which was primarily codified at FASB ASC 740-10) for certain nonpublic entities, including nonpublic not-for-profit entities to the annual financial statements for fiscal years beginning after December 15, 2008. The second phase is directed towards developing application guidance on FASB Interpretation No. 48 for pass through entities and not-for-profit entities.

.243 In mid-2009, FASB issued and received comments on proposed FSP FIN 48-d, *Application Guidance for Pass-through Entities and Tax-Exempt Not-for-Profit Entities and Disclosure Modifications for Nonpublic Entities.* The proposed FSP addresses the following 3 issues related to the application of FASB Interpretation No. 48 to pass through entities and tax exempt not-for-profit entities:

- Definition of a tax position
- Attribution of income taxes to the entity or its owners
- Financial statements of a group of related entities

.244 The board will redeliberate the issues in the proposed FSP based on the comment letters and is expected to issue final guidance in the third quarter of 2009. Readers should be alert for developments on this topic.

Other Accounting Projects

.245 In addition to those discussed in this alert, FASB also has the following projects underway:

- Credit crisis projects that include the following:
  - Embedded credit derivatives scope exceptions
  - Recoveries of other-than-temporary impairments
  - Improving disclosures about fair value measurements (proposed ASU released on August 28, 2009)
  - Applying fair value to interests in alternative investments
- Loan loss disclosures (as discussed in the "Other Accounting and Financial Management Considerations" section of this alert)
- Accounting and reporting for decreases in ownership of a subsidiary—a scope clarification (proposed ASU released on August 28, 2009)
- Disclosure framework
- Phase 2 of postretirement benefit obligations, including pensions
- Oil and gas disclosures
- Treatment of base jackpot liabilities of casinos
- Earnings per share
- Reporting discontinued operations
- Insurance contracts
- Consolidation: Policy and procedures
- Emissions trading schemes
- Financial instruments—Improvements to recognition and measurement

Resource Central

.246 The following are various resources that practitioners may find beneficial.

Publications

.247 Choose the format best for you—online, print, or CD-ROM.

- Audit Guide *Analytical Procedures* (2008) (product no. 012558 [paperback], WAN-XX [online], or DAN-XX [CD-ROM])
- Audit Guide *Assessing and Responding to Audit Risk in a Financial Statement Audit* (2006) (product no. 012456 [paperback] or WRA-XX [online])
- Audit Guide *Auditing Revenue in Certain Industries* (2009) (product no. 012519 [paperback], WAR-XX [online], or DAR-XX [CD-ROM])
- Audit Guide *Audit Sampling* (2008) (product no. 012538 [paperback], WAS-XX [online], or DAS-XX [CD-ROM])

- Audit Guide *Service Organizations: Applying SAS No. 70, as Amended* (2009) (product no. 012779 [paperback], WSV-XX [online], or DSV-XX [CD-ROM])
- Audit Risk Alert *Compilation and Review Developments—2008* (product no. 022309 [paperback], WCR-XX [online], or DCR-XX [CD-ROM])
- Audit Risk Alert *Independence and Ethics Developments—2009* (product no. 0224709 [paperback], WIA-XX [online], or DIA-XX [CD-ROM])
- *Checklists and Illustrative Financial Statements for Corporations* (product no. 008939 [paperback] or WCP-CL [online])
- *Accounting Trends & Techniques, 62nd Edition* (product no. 009900 [paperback] or WAT-XX [online])
- *Audit and Accounting Manual* (2009) (product no. 0051309 [paperback], WAM-XX [online], or AAM-XX [loose leaf])
- Audit and Accounting Practice Aid *Independence Compliance: Checklists and Tools for Complying With AICPA and GAO Independence Requirements* (product no. 006661 [paperback])
- Audit and Accounting Practice Aid *Independence Compliance: Checklists and Tools for Complying With AICPA, SEC, and PCAOB Independence Requirements* (product no. 006660 [paperback])

.248 Additional resources for accountants in business and industry are the Financial Reporting Alert series, designed to be used by members of an entity's financial management and audit committee to identify and understand current accounting and regulatory developments affecting the entity's financial reporting.

- Financial Reporting Alert *Current Economic Crisis: Accounting Issues and Risks for Financial Management and Reporting—2009* (product no. 0292009 [paperback])
- Financial Reporting Alert *Not-for-Profit Organizations: Accounting Issues and Risks—2009* (product no. 0292209 [paperback])

AICPA reSOURCE: Accounting and Auditing Literature

.249 The AICPA has created your core accounting and auditing library online. AICPA reSOURCE is now customizable to suit your preferences or your firm's needs. Or, you can sign up for access to the entire library. Get access—anytime, anywhere—to the FASB ASC, AICPA's latest *Professional Standards*, *Technical Practice Aids*, Audit and Accounting Guides, Audit Risk Alerts, *Accounting Trends & Techniques*, and more. To subscribe to this essential online service for accounting professionals, visit www.cpa2biz.com.

AICPA Accounting Guidance Library

.250 AICPA Resource Online now offers FASB ASC. As discussed previously in this alert, FASB ASC significantly changes the structure and hierarchy of accounting and reporting standards into a topically organized format.

.251 In this extraordinary member value, the AICPA is offering online access to FASB ASC along with our most popular Audit and Accounting Guides for only $659 for a 1 year subscription (product number WGC-XX).

.252 This new library gives you online access to FASB ASC and the following AICPA Audit and Accounting Guides:

- *Construction Contractors*
- *Depository and Lending Institutions*
- *Employee Benefit Plans*
- *Investment Companies*
- *Life and Health Insurance Entities*
- *Not-for-Profit Entities*
- *Property and Liability Insurance Entities*

.253 The guides have been fully conformed and linked to FASB ASC and will help ease your transition to the new structure. In addition, these guides provide a key entry point to understanding the impact of FASB ASC on your work.

.254 While working in FASB ASC on AICPA Resource Online, you will be able to

- perform a full-text search.
- browse by topic.
- quick go to navigation to a specific FASB ASC reference.
- access a cross reference report that identifies where legacy material is now located and link directly to that content.
- view the source of the codified content.
- join sections and subsections.
- access an archive function of previous versions of FASB ASC content.
- see all FASB ASC content that links to a given paragraph.

.255 Subscribe today and make the transition to the new FASB ASC at a member-only value price of $659. Discounted multiuser subscriptions are available for this library. To order, call 888-777-7077 or go to www.cpa2biz.com.

CPE

.256 The AICPA offers a number of CPE courses that are valuable to CPAs working in public practice and industry, including the following:

- *AICPA's Annual Accounting and Auditing Update Workshop (2009–2010 Edition)* (product no. 736185 [text] or 187193 [DVD]). Whether you are in industry or public practice, this course keeps you current and informed and shows you how to apply the most recent standards.
- *SEC Reporting* (product no. 736776 [text] or 186757 [DVD]). Confidently comply with the latest SEC reporting requirements with this comprehensive course. It clarifies new, difficult, and important reporting and disclosure requirements and gives you examples and tips for ensuring compliance.
- *International Versus U.S. Accounting: What in the World is the Difference?* (product no. 731667 [text]). Understanding the differences between IFRS and U.S. GAAP is becoming more important

for businesses of all sizes. This course outlines the major differences between IFRS and U.S. GAAP.

- *The International Financial Reporting Standards: An Overview* (product no. 157220 [online] or 739750HS [CD-ROM]). This course captures a live presentation on IFRS given to the AICPA board of directors.

.257 Among the many courses, the following are specifically related to the current economic conditions:

- *Fair Value Accounting: A Critical New Skill for All CPAs* (product no. 733301 [text] or 183301 [DVD]). The course covers the conceptual and practical issues that arise when fair value measurement is implemented under existing FASB standards and provides examples of these issues.
- *Revenue Recognition in Today's Business Climate* (product no. 732424 [text]). This course reviews the current literature, looks at the implications of premature recognition, examines unique revenue recognition issues of specialized industries, and examines current FASB projects and the impact they will have on financial statements.
- *Forensics and Financial Fraud* (product no. 733201 [text]). This course provides specific steps to help auditors and accountants fully meet fraud handling expectations. The how-to approach helps identify fraud exposures and risks and provides practical ideas on how to handle those exposures.

Visit www.cpa2biz.com for a complete list of CPE courses.

Online CPE

.258 AICPA CPExpress, offered exclusively through CPA2Biz, is the AICPA's flagship online learning product. AICPA members pay $180 for a new subscription and $149 for the annual renewal. Nonmembers pay $435 for a new subscription and $375 for the annual renewal. Divided into 1 credit and 2 credit courses that are available 24 hours a day, 7 days a week, AICPA CPExpress offers hundreds of hours of learning in a wide variety of topics. Some topics of special interest may include the following:

- *Current Economic Crisis: Critical Accounting and Auditing Considerations*
- *Fair Value Accounting: A Critical New Skill For All CPAs*
- *Fraud–Identifying Fraudulent Financial Transactions*
- *Accounting and Auditing Annual Updates*
- *SEC/PCAOB Annual Updates*
- *Accounting & Auditing Quarterly Updates*
- *Financial Management During the Economic Downturn*

.259 To register or learn more, visit www.cpa2biz.com.

Webcasts

.260 Stay plugged in to what is happening and earn CPE credit right from your desktop. AICPA webcasts are high quality, two hour CPE programs that bring you the latest topics from the profession's leading experts. Broadcast live, they allow you to interact with the presenters and join in the discussion. If you cannot make the live event, each webcast is archived and available on CD-ROM.

CFO Quarterly Roundtable Series

.261 The CFO Quarterly Roundtable Series, brought to you each calendar quarter via webcast, covers a broad array of "hot topics" that successful organizations employ and subjects that are important to the CFO's personal success. From financial reporting, budgeting, and forecasting to asset management and operations, the roundtable helps CFOs, treasurers, controllers, and other financial executives excel in their demanding roles.

SEC Quarterly Update Series

.262 The SEC Quarterly Update Webcast Series, brought to you each calendar quarter, showcases the profession's leading experts on what is "hot" at the SEC. From corporate accounting reform legislation and new regulatory initiatives to accounting and reporting requirements and corporate finance activities, these hard-hitting sessions will keep you "plugged in" to what is important. A must for preparers in public companies and practitioners who have public company clients, this is the place to be when it comes to knowing about the areas of current interest at the SEC.

IFRS Quarterly Webcast Series

.263 The IFRS Quarterly Webcast Series, brought to you each calendar quarter, is part of a multistep educational process to get practitioners, financial managers, and auditors up to speed on all aspects of IFRSs implementation. Over the course of the quarterly series, IFRSs will be covered in depth. International harmonization is quickly approaching, and this series will help both accountants and auditors stay abreast of the developments and changes they will need to implement.

Member Service Center

.264 To order AICPA products, receive information about AICPA activities, and get help with your membership questions, call the AICPA Service Operations Center at (888) 777-7077.

Hotlines

Accounting and Auditing Technical Hotline

.265 Do you have a complex technical question about GAAP, OCBOA, or other technical matters? If so, use the AICPA's Accounting and Auditing Technical Hotline. AICPA staff will research your question and call you back with the answer. The hotline is available from 9 a.m. to 8 p.m. EST on weekdays. You can reach the Technical Hotline at (877) 242-7212 or online at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+and+Auditing+Technical+Help/.

Ethics Hotline

.266 In addition to the Technical Hotline, the AICPA also offers an Ethics Hotline. Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. You can reach the Ethics Hotline at (888) 777-7077 or by e-mail at ethics@aicpa.org.

The CAQ

.267 The CAQ, which is affiliated with the AICPA, was created to serve investors, public company auditors, and the markets. The CAQ's mission is to foster confidence in the audit process and aid investors and the capital markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty, and trust.

.268 To accomplish this mission, the CAQ works to make public company audits even more reliable and relevant for investors in a time of growing financial complexity and market globalization. The CAQ also undertakes research, offers recommendations to enhance investor confidence and the vitality of the capital markets, issues technical support for public company auditing professionals, and helps facilitate the public discussion about modernizing business reporting. The CAQ is a voluntary membership center that provides education, communication, representation, and other means to member firms that audit or are interested in auditing public companies. To learn more about the CAQ, visit http://thecaq.aicpa.org.

.269 This Audit Risk Alert replaces *Current Economic Crisis: Accounting and Auditing Considerations—2009*. As you encounter audit or industry issues that you believe warrant discussion in next year's Audit Risk Alert, please feel free to share them with us. Any other comments that you have about the Audit Risk Alert also would be appreciated. You may e-mail these comments to klichtenstein@aicpa.org or write to

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Appendix—Additional Web Resources

Here are some useful Web sites that may provide valuable information to accountants.

Web Site Name	*Content*	*Web Site*
AICPA	Summaries of recent auditing and other professional standards, as well as other AICPA activities	www.aicpa.org www.cpa2biz.com www.ifrs.com
AICPA Accounting and Review Services Committee	Summaries of review and compilation standards and interpretations	www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Accounting+and+Review+Services+Committee
AICPA Professional Issues Task Force	Summaries of practice issues that appear to present concerns for practitioners and disseminate information or guidance, as appropriate, in the form of practice alerts	www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Professional+Issues+Task+Force
AICPA Accounting Standards Executive Committee	Summaries of recently issued guides, technical questions and answers, and practice bulletins containing financial, accounting, and reporting recommendations, among other things	www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards
Economy.com	Source for analyses, data, forecasts, and information on the United States and world economies	www.economy.com
The Federal Reserve Board	Source of key interest rates	www.federalreserve.gov
Financial Accounting Standards Board (FASB)	Summaries of recent accounting pronouncements and other FASB activities	www.fasb.org

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Web Site Name	*Content*	*Web Site*
International Accounting Standards Board	Summaries of International Financial Reporting Standards and International Accounting Standards	www.iasb.org
International Auditing and Assurance Standards Board	Summaries of International Standards on Auditing	www.iaasb.org
International Federation of Accountants	Information on standards setting activities in the international arena	www.ifac.org
Private Company Financial Reporting Committee	Information on the initiative to further improve FASB's standard setting process to consider needs of private companies and their constituents of financial reporting	www.pcfr.org
Public Company Accounting Oversight Board (PCAOB)	Information on accounting and auditing activities of the PCAOB and other matters	www.pcaob.org
Securities and Exchange Commission (SEC)	Information on current SEC rulemaking and the Electronic Data Gathering, Analysis, and Retrieval database	www.sec.gov
USA.gov	Portal through which all government agencies can be accessed	www.usa.gov